NOTE

This Microfiche meets the quality requirements of the American National Standard for Microfiche of Documents (ANSI PH5.9-1975). However, because of imperfections in the document from which it was made, it contains images that are illegible or difficult to read. The source document for this microfiche is the best copy that could be obtained prior to filming.

CIS Congressional Information Service Washington, D.C.

FUEL ETHANOL IMPORTS FROM CARIBBEAN BASIN INITIATIVE COUNTRIES

HEARING

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

APRIL 25, 1989

Serial 101-25

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

19-676 WASHINGTON : 1989

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

H781-71

COMMITTEE ON WAYS AND MEANS

DAN ROSTENKOWSKI, Illinois, *Chairman*

SAM M. GIBBONS, Florida
J.J. PICKLE, Texas
CHARLES B. RANGEL, New York
FORTNEY PETE STARK, California
ANDY JACOBS, JR., Indiana
HAROLD FORD, Tennessee
ED JENKINS, Georgia
RICHARD A. GEPHARDT, Missouri
THOMAS J. DOWNEY, New York
FRANK J. GUARINI, New Jersey
MARTY RUSSO, Illinois
DON J. PEASE, Ohio
ROBERT T. MATSUI, California
BERYL ANTHONY, JR., Arkansas
RONNIE G. FLIPPO, Alabama
BYRON L. DORGAN, North Dakota
BARBARA B. KENNELLY, Connecticut
BRIAN J. DONNELLY, Massachusetts
WILLIAM J. COYNE, Pennsylvania
MICHAEL A. ANDREWS, Texas
SANDER M. LEVIN, Michigan
JIM MOODY, Wisconsin

BILL ARCHER, Texas
GUY VANDER JAGT, Michigan
PHILIP M. CRANE, Illinois
BILL FRENZEL, Minnesota
DICK SCHULZE, Pennsylvania
BILL GRADISON, Ohio
WILLIAM M. THOMAS, California
RAYMOND J. McGRATH, New York
HANK BROWN, Colorado
ROD CHANDLER, Washington
E. CLAY SHAW, JR., Florida
DON SUNDQUIST, Tennessee
NANCY L. JOHNSON, Connecticut

ROBERT J. LEONARD, *Chief Counsel and Staff Director*
PHILLIP D. MOSELEY, *Minority Chief of Staff*

SUBCOMMITTEE ON TRADE

SAM M. GIBBONS, Florida, *Chairman*

DAN ROSTENKOWSKI, Illinois
ED JENKINS, Georgia
THOMAS J. DOWNEY, New York
DON J. PEASE, Ohio
MARTY RUSSO, Illinois
RICHARD A. GEPHARDT, Missouri
FRANK J. GUARINI, New Jersey
ROBERT T. MATSUI, California

PHILIP M. CRANE, Illinois
GUY VANDER JAGT, Michigan
BILL FRENZEL, Minnesota
DICK SCHULZE, Pennsylvania
WILLIAM M. THOMAS, California

CONTENTS

Page

Press release of Thursday, April 13, 1989, announcing the hearing 2

WITNESSES

U.S. General Accounting Office, Allan I. Mendelowitz, Director, Trade, Energy, and Finance Issues, National Security and International Affairs Division; Wayne Farrish, Project Manager; and Barbara Keller-Cohen, Senior Evaluator 34

U.S. International Trade Commission, Vern Simpson, Acting Director, Office of Industries; Edmund Cappuccilli, Chief, Energy, Petroleum, Benzenoid Chemicals, and Rubber and Plastics Branch; and Joseph Francois, Trade Economist 46

A.E. Staley Co., Linden Shepard 67

Anthony, Hon. Beryl, Jr., a Representative in Congress from the State of Arkansas 4

Columbus, R. Timothy, Petrojam, Ltd 113

Corn Coalition, William E. Snyder 151

Durbin, Hon. Richard J., a Representative in Congress from the State of Illinois 10

Graf, Kathleen, Graf Feed & Fuel Alcohol, and Minnesota Ethanol Commission 194

Kirk, William A., Tropicana International Ltd 80

Liga Agricola Industrial de la Cana de Azucar, Eugene T. Rossides 122

Maloney, William, Tropicana International Ltd 80

Minnesota Ethanol Commission, Kathleen Graf 194

National Corn Growers Association, Steven Wentworth 142

Petrojam Ltd., R. Timothy Columbus 113

Renewable Fuels Association, Linden Shepard and Eric Vaughn 67

Rossides, Eugene T., Liga Agricola Industrial de la Cana de Azucar 122

Shepard, Linden, Renewable Fuels Association and A.E. Staley Co 67

Southerland, James, VIAG Fuels, Inc 122

Snyder, William E., Corn Coalition 151

Tropicana International Ltd., William Maloney and William A. Kirk 80

Vaughn, Eric, Renewable Fuels Association 67

VIAG Fuels, Inc., James Southerland 122

Wentworth, Steven, National Corn Growers Association 142

SUBMISSIONS FOR THE RECORD

Office of the U.S. Trade Representative, Joshua B. Bolten, Acting Deputy U.S. Trade Representative 207

Allied Ethanol, Ltd., Grand Bahamas Island, Grand Bahamas, Burton M. Joseph, statement and attachment 211

Caribbean/Central American Action, Peter B. Johnson, statement 215

Cenex, St. Paul, Minn., statement 217

Costa Rica, Republic of, President Oscar Arias Sanchez, letter 224

El Paso Refining Co., Ltd., David N. Jones, letter 225

Hartney Oil Co., Forest View, Ill., Peter A. Hartney, letter 226

Minnesota Corn Processors, Donald F. Stella, letter 227

National Petroleum Refiners Association, statement 229

North Carolina Ethanol, Ltd., Guy D. Griswold, statement 231

S&F Petroleum Co., Inc., Adkins, Tex., Steven F. Farley, letter 238

FUEL ETHANOL IMPORTS FROM CARIBBEAN BASIN INITIATIVE COUNTRIES

TUESDAY, APRIL 25, 1989

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TRADE,
Washington, DC.

The subcommittee met, pursuant to notice, at 1 p.m., in room B-318, Rayburn House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
THURSDAY, APRIL 13, 1989

SUBCOMMITTEE ON TRADE #8
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-1721

THE HONORABLE SAM M. GIBBONS (D., FLA.), CHAIRMAN, SUBCOMMITTEE ON TRADE, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A HEARING ON FUEL ETHANOL IMPORTS FROM CARIBBEAN BASIN INITIATIVE COUNTRIES

The Honorable Sam M. Gibbons (D., Fla.), Chairman of the Subcommittee on Trade, Committee on Ways and Means, U.S. House of Representatives, today announced a public hearing on the issue of fuel ethanol imports from Caribbean Basin Initiative countries. The hearing will be held on Tuesday, April 25, 1989, in room B-318 Rayburn House Office Building, beginning at 1:00 p.m.

The 1983 Caribbean Basin Economic Recovery Act permits eligible products from designated countries and U.S. insular possessions in Central America and the Caribbean (CBI countries) to be imported into the United States duty-free, subject to certain conditions. A 1986 statutory change provided that ethanol from CBI countries could enter the United States duty-free only if feedstock from the region accounted for at least 75 percent of the value of the ethanol by 1989.

The Omnibus Trade and Competitiveness Act of 1988 required the U.S. General Accounting Office (GAO) and the U.S. International Trade Commission (ITC) to study whether the 75-percent local feedstock requirement will contribute to the economic development of the CBI countries, and whether the requirement is economically feasible for ethanol producers. Both reports have been submitted to the Committee on Ways and Means, and have recommended changes to the existing local feedstock requirements.

The Subcommittee hearing will focus on the impact of existing requirements governing imports of fuel ethanol from CBI countries, and consider the proposals for change contained in the GAO and ITC reports. The Subcommittee is interested in hearing the views of the Administration and the private sector on whether existing requirements need to be altered and, if so, how they should be changed.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD:

Requests to be heard must be made by telephone to Harriett Lawler or Diane Kirkland [telephone (202) 225-1721] by close of business Wednesday, April 19, 1989. The telephone request should be followed by a formal written request to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, room 1102 Longworth House Office Building, Washington, D.C. 20515. The Subcommittee staff will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee office [(202) 225-3943].

In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

(MORE)

Witnesses scheduled to present oral testimony are requested to briefly summarize their written statements. The full statement will be included in the printed record.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, witnesses scheduled to appear before the Subcommittee are required to submit 150 copies of their prepared statement to the Subcommittee on Trade office, room 1136 Longworth House Office Building, at least 24 hours in advance of their scheduled appearance. Failure to do so may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Persons submitting a written statement in lieu of a personal appearance should submit six (6) copies of their statement by the close of business Monday, May 1, 1989, to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, room 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing a written statement for the record of the printed hearing wish to have their statement distributed to the press and the interested public at the hearing, they may provide 75 additional copies for this purpose to the Subcommittee office, room 1136 Longworth House Office Building, prior to the start of the public hearing.

SEE FORMATTING REQUIREMENTS BELOW:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and public during the course of a public hearing, may be submitted in other forms.

* * * * * * * * * * *

Chairman GIBBONS. Good afternoon. This is a hearing of the Subcommittee on Trade to consider the issue of ethanol production in the Caribbean countries, and to evaluate proposals for changing the requirements for imports contained in current law. As of January 1990, ethanol dehydrated within CBI beneficiary countries will be able to enter the United States duty-free only if feedstock from the region accounts for at least 75 percent of the value of the ethanol. Ethanol which is both dehydrated and fermented within such countries would be eligible for duty-free treatment without regard to local feedstock.

The Omnibus Trade and Competitiveness Act of 1988 required the General Accounting Office and the International Trade Commission to study whether the 75-percent local feedstock requirement will contribute to the economic development of the CBI countries, and whether the requirement is economically feasible for ethanol producers. Both reports have addressed this issue, and GAO has outlined several options for changes to the existing local feedstock requirement.

Our testimony today will help the subcommittee to better understand the problem and, hopefully, to determine whether another course of action can be taken to allow for continued production of ethanol in CBI countries.

In light of our time constraints, and to allow as much time as possible for questions, I would ask the witnesses to confine their oral testimony to 5 minutes and submit their written statements for the record. But we won't be too hard on the gavel—if you want to talk longer than that, then we'll let you go.

Our first witnesses are our esteemed colleagues, Beryl Anthony of Arkansas, also a member of the Committee on Ways and Means, and Richard Durbin of Illinois, a fine friend who has been so interested in this issue for so long.

Gentlemen, you may proceed. Beryl, I called your name first so why don't you go first. We've arranged these panels so they would be a little combative today, and I hope I will not be disappointed. [Laughter.]

STATEMENT OF HON. BERYL ANTHONY, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ARKANSAS

Mr. ANTHONY. Mr. Chairman, I will submit my written testimony for the record, and with your permission I would like to summarize some of my thoughts and give you some indication as to how I, personally, became——

Chairman GIBBONS. Without objection, let's get all of the statements admitted for the record. All of them will be put into the record as if delivered, and the Members may do anything they want to with them orally.

Mr. ANTHONY. Mr. Chairman, just very quickly. I went on a Caribbean fact finding trip at the request of President Reagan. I was invited by Chairman Rostenkowski to make that trip. As a result of what we learned on that trip, I, along with other members of the Ways and Means Committee, came back totally committed to trying to pass the first Caribbean Basin Initiative legislation.

Chairman GIBBONS. The gentleman's very helpful.

Mr. ANTHONY. If you recall, as a result of those first meetings, I became very interested in the rum legislation, probably the most controversial issue in the original bill. I supported that provision because I thought economically, over and above tourism, that's where the Caribbean countries could be helped. As a result, we were able to reach a compromise in that particular area.

As you well know, many other special interest groups testified, and there were lots of amendments, but consensus was reached and the bill was passed. As a result, President Reagan asked that Chairman Rostenkowski take another delegation back down a few years later to determine whether or not the initiative was, in fact, working.

We have done that, and it is still being closely monitored. It has not worked as well as we had hoped, but its existence provides hope and opportunity for those Caribbean democratic countries to proceed economically.

I specifically got involved in the ethanol issue at approximately 2 in the morning on the last days of the markup of the 1986 Tax Reform Act. The Trade Subcommittee staff came before the committee and began testifying about ethanol, at which time I voiced my objection to the chairman of the full Committee stating that "I didn't think we should be doing something on trade in the Tax Reform Act."

As a result of my comments then, the chairman directed me to see if I could work out a compromise that night. I met with the interested parties and attempted to hammer out a compromise.

The compromise which was eventually reached was one I personally believed to be unfair to the Caribbean countries; and in fact, during markup of the Tax Reform of 1986, I offered an amendment striking this "compromise language," I spoke out against it, and voted against it, but I was overridden.

As a result, the industry discovered that they could not live up to the legislative compromise and I asked to help them obtain relief. After a 2-year battle for relief, language was included in the trade bill of this past year. I was opposed to that compromise because I didn't think it was one which the industry could live up to and that it would ultimately be harmful to the economy of the Caribbean country.

I was most interested in obtaining a neutral party study of the Caribbean ethanol industry. I was strongly supportive of GAO taking a look at this problem because what you basically had were domestic companies arguing one position through their representatives and the Caribbean countries debating another position through their representatives and then those like myself who don't have producers nor growers in the district trying to weigh all of the factors in reaching a decision on this matter.

I'm here today to tell you, Mr. Chairman, that the GAO report basically bears out the arguments which I have personally been making for many years. One, that there is no passthrough problem; two, that there is significant employment and economic activity in the Caribbean country; and third, and most importantly, that there is no long range harm domestically to the ethanol industry because we're only talking about a 3-percent-import penetration.

I would say to the members of the subcommittee this, that when you weigh the degree of import penetration of ethanol against the degree of import penetration we've suffered in many other industries—in my own State, I happen to represent an awful lot of shoe manufacturers in which we've experienced a 70-percent import penetration—I must admit that I don't understand how this domestic industry can come forward to the Congress and ask for continued relief.

So, it's a matter of balance—the equities between trying not to harm a domestic industry, making sure that there is an adequate supply of fuel for U.S. blenders and U.S. marketers who would like to sell gasohol, and at the same time avoid inflicting harm on our Caribbean friends. We must continue to encourage the development of democracy and a close working relationships between the United States and these countries, and provide them with the hope and opportunity to grow and expand—as they will tell you—through market forces and not welfare.

So Mr. Chairman, as just one member of the full committee who has spent a great deal of time analyzing this issue, I am here to encourage this subcommittee to provide all the necessary relief to the Caribbean countries, and to reassure the domestic industry that no harm would come to them if the Caribbean ethanol industry is allowed to continue to import into the U.S. market.

And I yield, and I would be happy to receive any questions from any members of the committee who disagree with anything I may have said.

[The statement of Hon. Beryl Anthony follows:]

STATEMENT BY REPRESENTATIVE BERYL ANTHONY, JR.
BEFORE
THE WAYS AND MEANS SUBCOMMITTEE ON TRADE
April 25, 1989

Mr. Chairman: Thank you for the opportunity to appear before you and the Members of this Subcommittee, today.

As you know, Mr. Chairman, I am a strong proponent and a cosponsor of the Caribbean Basin Initiative, which has encouraged domestic and foreign investment and has bolstered economic development efforts of our Caribbean partners. Since 1983, when Congress recognized the need to address the problem of economic and political instability in the region and the linkage to our national security concerns, this program has been instrumental in helping these countries avoid an economic crisis, and in striving for economic prosperity.

The benefits of this program to the Caribbean nations have been great, not only in the form of increased employment, foreign investments and overall increased economic activity, but also in the ability of these countries to service their heavy debts. The CBI program has not only bolstered the economies of our neighbors, but it has also expanded markets for U.S. goods and services, and decreased the outflow of U.S. economic aid. In other words, the U.S. has also received a good return on its investment.

The CBI ethanol industry is a product of that investment. This industry developed as a means of diversifying the economies away from the reliance on sugar as a primary export commodity. Our own government encouraged these countries and would-be investors to pursue the development of an ethanol industry in the Caribbean because of low sugar prices, anticipated decrease in U.S. sugar quotas, and the resulting loss of employment in the Caribbean sugar industry.

Now, however, after the investments have been made, and the potential exists for CBI ethanol producers to become viable suppliers for the U.S. market, we are considering destroying the industry. While ethanol is not among the list of articles exempted from duty-free treatment under the CBI program, this 75% local feedstock requirement would affectively add them to that list.

The GAO study concludes that given current gas and sugar prices, a 75% local feedstock requirement is prohibitive for Caribbean ethanol producers, and is inconsistent with policy objectives of the CBI. They further concluded that "because of competing demands for CBI sugarcane and wet ethanol, there is a limit on the amount of local feedstock currently available in the CBI region. This could affect CBI producer's ability to meet a local feedstock requirement. CBI producers have had difficulty in obtaining adequate supplies of local feedstock." (p.4)

Mr. Chairman, Members of the Subcommittee, the findings of this study provide clear evidence that the Caribbean ethanol industry "has had little impact on domestic producers." A 1986 ITC report also found no credible evidence of competition or displacement of domestic production, and came to the same conclusion again this last Fall, as cited in the GAO report. Why then are we considering imposing these prohibitive requirements on this industry?

The Caribbean ethanol industry is small. Yet according to the GAO report, these facilities do provide benefits to the local economy in the form of capital investments, employment, tax revenue, consumption of local goods and services, and revenue for local port authorities. If local feedstock requirement is higher than what is economically feasible, these benefits to the local economy will be lost.

Also, speculations of the devastating impact of CBI ethanol entering the U.S. under the 20 million-gallon cap during this interim period have not come to fruition. Even in 1987, at peak production, the volume of ethanol imports from this region amounted to only 3% of the total U.S. market. Now how can one argue that this is adversely impacting the domestic producers?

Current U.S. consumption level is 850 million gallons annually, yet the GAO estimated that combined production capacity of existing CBI ethanol plants ranges from between 88 and 212 million gallons annually. Furthermore, GAO findings indicated that current domestic ethanol sales are far below the potential market capacity.

Mr. Chairman, I am every bit as concerned about the domestic ethanol producers as the Members of this Subcommittee here today. But contrary to claims that CBI ethanol has an unfair cost advantage, and will displace domestic ethanol in U.S. markets, there is every indication that CBI producers are more likely to develop new markets or transport their ethanol to coastal markets where supply shortages have been experienced.

Furthermore, when one compares the average cost of production for the U.S. ethanol industry ($0.57 to $1.80 per gallon) to the cost for CBI ethanol producers ($1.30-1.41 per gallon with a 75% feedstock requirement, or even $1.03-1.17 per gallon with a 30% feedstock requirement) the unfair cost advantage is somewhat disputable; especially given that the average U.S. ethanol price ranges from $1.06 to $1.08/gallon.

In closing, I continue to believe that promotion of free-enterprise attraction of foreign investment and expansion of non-traditional exports constitutes the best possibility of achieving genuine economic growth and prosperity for the Caribbean region over the long term. We must continue the active commitment by the U.S. to encourage business investments in this area, and to assist their efforts to develop and promote non-traditional exports, and not to change the rules on them in the middle of the game.

Congress was concerned enough about the impact of the 75% local feedstock requirements on the CBI ethanol industry, last year, that we mandated a GAO and ITC study, and agreed to cap the volume at 20 MGY until the study was completed. Well, the findings are in, and I suggest that we implement the recommendations provided in the report.

Thank you.

Chairman GIBBONS. If you wouldn't mind, would you wait until we hear from Mr. Durbin so we can ask questions of both of you at the same time?

Mr. ANTHONY. Yes, sir.

Chairman GIBBONS. Mr. Durbin.

STATEMENT OF HON. RICHARD J. DURBIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. DURBIN. Thank you, Mr. Chairman. I thank the members of the committee. I might add that my colleague, Bob Michel, was anxious to join this hearing today, but his schedule did not allow it, and he wanted to associate himself, at least in general, with my remarks. I believe that we share, or at least substantially share the same position on this issue.

I am glad that this subcommittee has come together on this important issue. It's of particular importance to me for being from the State of Illinois and being from downstate Illinois where there's a lot of corn that's grown. I think you will hear from some later witnesses the significance of the ethanol industry to corn growers across the United States.

As each 2.5 gallons of ethanol consumes one bushel of corn, the demand for corn for use in ethanol production has risen from 8 million bushels in 1979 to 340 million bushels in 1988. This added $1 billion in farm income in 1988 and reduced the cost of Federal foreign programs by $700 million. It is an important agricultural issue. I would be remiss if I didn't add that in my part of the world, most of the domestic ethanol in the United States is processed, primarily in Decatur, but also in Pekin, IL. About half of the ethanol in the United States is being manufactured these as we speak. So, it's an important source not only of farm income, but also of local employment.

When Congress passed the Caribbean Basin Initiative, it was very clear to those who explained the issue on the floor that the objective was to create a growing economy and growing employment in the Caribbean Basin. It was argued to the Members of Congress that this was consistent with America's strategic needs in the area, and also consistent with our policy of making certain that our neighbors in that area had an opportunity to see their own economies grow.

It was curious to me shortly after the passage of that legislation that a number of processors found a loophole within it by which they could go into what is known as dehydration facilities in the Caribbean Basin, and in fact export ethanol to the United States duty-free. By so doing, they reaped great profit from it. As a result, we had several meetings, several discussions to try to establish some way to return to the real mission of the Caribbean Basin Initiative, to create employment in the Caribbean.

We went through a long series of negotiations over 4 or 5 years. We finally hammered out an agreement which required that a substantial percentage of the feedstock to make the ethanol had to come from the Caribbean. If, in fact, the Caribbean Basin Initiative was designed to help those countries, it stood to reason that we had to basically find a way to make certain that it was using local feed-

stock, employing local people. That agreement was reached, and the ink had hardly dried on the paper before some of the companies returned to this committee and asked for relief.

Last year, the committee decided to change the terms of an earlier agreement and gave five Caribbean facilities an exemption from the Caribbean feedstock requirement for 1988 and 1989. I objected to that change on the grounds that it would undercut the market for domestic ethanol in the United States while not providing any significant benefit to the people of the Caribbean.

The grandfather clause for Caribbean producers in current law allows them to buy subsidized European wine alcohol, ship it to the Caribbean for final processing, import it in the United States and claim the tariff exemption granted to Bona Fides Caribbean products. This provision is a gross violation of the stated purpose of the Caribbean Basin Initiative, since it doesn't require the use of any Caribbean feedstock in the production of the so-called Caribbean ethanol.

Now, the International Trade Commission has recently released a report, which my colleague Mr. Anthony referred to. It's interesting what they said, and I quote "From 1985 through September, 1988, approximately 68 percent of the fuel ethanol imported from the Caribbean Basin countries was produced from surplus wine alcohol." It went on to say, "The primary feedstock used by the Caribbean ethanol industry to produce the nonindigenous portion of the fuel ethanol for export to the United States has been surplus European wine alcohol, the so-called European 'wine lake.'"

The primary point I would like to leave with my colleagues today is the real issue in this debate is whether we are going to give a tax incentive for U.S. sales of a product that is made primarily from surplus wine alcohol, and whether a substantial number of jobs are created in the Caribbean as a result.

And I would conclude that they are not. The International Trade Commission study indicates that there is a potential difference of over 11,000 jobs in Caribbean employment between a Caribbean ethanol industry built on a 10-percent Caribbean feedstock requirement and industry built on a 60-percent Caribbean feedstock requirement. This is based on 1988 corn, sugar, and gasoline prices.

If we wanted to create new jobs, if we wanted to improve the economy in the Caribbean with the CBI, then clearly we didn't have in mind the idea of creating a loophole, where in fact the Europeans can dump their surplus wine, dehydrate it at very little cost and creating very few jobs in the Caribbean, and then export it to the United States duty-free at the expense of American taxpayers.

The simple question, as I see it, that faces this subcommittee when it comes to resolving this issue, is whether in fact we want to have a Caribbean Basin Initiative or a surplus European wine initiative. If that is the case, then let's so state. Let the American taxpayers face that, but I honestly believe that what we had in mind initially is the true purpose of the Caribbean Basin Initiative. Let us say to those who want to export ethanol to the United States, "Just follow the rules; don't look for a loophole, and don't look for us to subsidize your exports in the name of helping the Caribbean if in fact you are not creating jobs."

Mr. Chairman, with your permission I would like to submit my entire statement for the record.

[The statement of Hon. Richard J. Durbin follows:]

STATEMENT OF

THE HONORABLE RICHARD J. DURBIN
MEMBER OF CONGRESS

BEFORE THE

WAYS AND MEANS SUBCOMMITTEE ON TRADE

April 25, 1989

I would like to thank the Chairman for the opportunity to testify today on the issue of ethanol imports from Caribbean Basin Initiative countries.

As the committee members are aware, this is a subject about which I have a great deal of interest. Ethanol is an important part of the farm economy of central Illinois, providing jobs and a major outlet for our surplus corn.

In 1986, after this committee held hearings on the Caribbean ethanol issue, an agreement was reached that established the principle that Caribbean ethanol facilities should be required to use an increasing percentage of Caribbean feedstocks in order to receive the special duty-free treatment accorded by the Caribbean Basin Initiative.

Last year, the Committee decided to change the terms of that agreement and gave five Caribbean facilities an exemption from the Caribbean feedstock requirement for calendar years 1988 and 1989. I objected to that change on the grounds that it would undercut the markets of domestic ethanol producers while not providing any significant benefit to the people of the Caribbean.

The grandfather clause for Caribbean producers in current law allows them to buy subsidized European wine alcohol, ship it to the Caribbean for final processing, import it into the U.S., and claim the tariff exemption granted to bona fide Caribbean products. This provision is a gross violation of the basic purposes of the Caribbean Basin Initiative, since it does not require the use of any Caribbean feedstocks in the production of so-called "Caribbean" ethanol.

Supporters of the grandfather provision in last year's trade bill have suggested that our concerns are exaggerated and Caribbean ethanol producers will not utilize the transshipment scheme I have described to process European feedstocks. However, as the recent studies released by the General Accounting Office and the International Trade Commission show, the only reason Caribbean companies want an exemption or a major relaxation of the Caribbean feedstock requirement is so that they can use non-Caribbean feedstocks and still claim the special trade concessions that have been granted to CBI countries.

The ITC study says, "From 1985 through September 1988, approximately 68 percent of the fuel ethanol imported from the Caribbean Basin countries was produced from surplus wine alcohol." (p. 3-2; p. 3-3 in the original release) It goes on to say, "The primary feedstock used by the Caribbean ethanol industry to produce the nonindigenous portion of their fuel ethanol for export to the United States has been surplus European wine alcohol, the European 'wine lake.'" (p. 3-7; p. 3-19 in the original release)

The GAO study also recognizes that dehydration of European wine alcohol is the primary alternative to an indigenous Caribbean ethanol industry when it says of its analytical approach, "We focused on European wine alcohol for the non-CBI feedstock, because that is what CBI companies have largely used and because these stocks are the source of concern to U.S. ethanol producers." (p. 17)

The primary point I would like to make to my colleagues today is that the real issues in this debate are whether we should be giving a tax incentive for U.S. sales of a product that is made primarily from surplus European wine alcohol, and whether a substantial number of jobs are created in the Caribbean as a result.

The tariff on imported ethanol was instituted to directly offset the excise tax exemption for fuel ethanol sales in the U.S., which encouraged the development of our domestic ethanol industry, in order to avoid exporting the benefits of that tax incentive to foreign countries. We made an exception for Caribbean countries when we passed the Caribbean Basin Initiative. We said that, for foreign policy reasons, if Caribbean producers set up full-fermentation facilities so that jobs would be created in the Caribbean, we would give them the same tax treatment as U.S. producers.

But grandfather clauses or minimal Caribbean feedstock requirements give away special trade concessions that encourage imports, without obtaining the offsetting benefit of jobs in the Caribbean. Dehydration facilities for European wine alcohol only provide a small number of jobs, while full-fermentation facilities can create thousands of additional jobs.

I do not want to be seen as an apologist for the ITC report. It has a number of flaws. It assumes that European wine alcohol is more expensive than actual purchases in the past few years would indicate. It downplays the negative impact of CBI ethanol imports on U.S. production and potential growth of the U.S. domestic ethanol industry. But for all its shortcomings, even the ITC report acknowledges that thousands of Caribbean jobs are at stake in this debate.

The ITC study indicates (Table 5-9) that there is a potential difference of 11,600 jobs in Caribbean employment between a Caribbean ethanol industry built on a a 10% Caribbean feedstock requirement and an industry built on a 60% Caribbean feedstock requirement. This is based on 1988 corn, sugar, and gasoline prices. The ITC analysis shows that an additional 2,500 jobs on top of that 11,600 can be created by enforcing a 75% Caribbean feedstock requirement. A higher feedstock requirement might reduce Caribbean ethanol production volume somewhat, but the potential increase in jobs would be dramatic as companies shift to Caribbean feedstocks. And, as Caribbean producers could confirm, the employment base in the Caribbean is so small that 14,100 jobs there is comparable to hundreds of thousands of jobs in the United States in terms of its impact on the economy.

So the choice before this committee is to select a feedstock requirement that will create thousands of jobs in the Caribbean, or to provide a convenient opportunity for the European Community to unload its surplus wine alcohol via the Caribbean, at U.S. taxpayer expense, with minimal benefit to the Caribbean economy. I urge the committee to come down on the side of Caribbean jobs and U.S. domestic ethanol production. It is a win-win proposition.

Chairman GIBBONS. Certainly, all statements will be submitted in their entirety.

First, I'd like to welcome not only subcommittee members to the hearing, but Mr. Dorgan of the full committee, who appeared in defense of the ethanol matter early that morning in 1986. I want to commend you for your efforts and for your alertness.

Richard, as I understand it, these CBI plants that have the grandfather constitute about 3 percent of the total U.S. production of ethanol. Does that correspond with what you said?

Mr. DURBIN. Mr. Chairman, I won't quarrel with what the percentages are today, but I think most of us see an expanding market for ethanol, and even those in the Caribbean seek spanned opportunities unless we set down some very precise rules. We are happy to report that oxygenated fuels are beginning to attract more attention, and not only create jobs for us, they are helping our environment.

Several weeks ago, General Motors, for example, announced that in all of their new cars in 1990 that they are going to recommend the use of oxygenated fuels. The American industry is creating a market for oxygenated fuels primarily because of air pollution concerns, I'm sure, and also some legislation that we've passed here on Capitol Hill.

So, it's not just a question of where the market is today but where it's going, and if we allow this glaring loophole to continue, we are not helping the Caribbean. We will surely help these producers. They will continue to make a lot of money, but at the expense, as I said earlier, of the American taxpayers.

Chairman GIBBONS. Well, the whole ethanol program is tremendously subsidized—our program is—by the taxpayers. I was wondering why it is such a burden for the ethanol industry in the United States to have 3-percent import penetration?

Mr. DURBIN. Mr. Chairman, I'm not going to quarrel with the fact that Congress reached this decision years ago to promote this industry, and I think those of us who live in the corn belt believe that this industry is just in its infancy. It has been growing, as my statistics indicated, very quickly. But it has a great potential beyond that, and when that occurs, as most of us believe it will, Congress can say that we had the vision to start an industry that now is going to serve the purposes of the United States very well in reducing our dependence on foreign oil, helping our farmers, and cleaning up the environment.

I'm not going to quarrel with that. And it's not just a question of 3 percent coming in, but the potential, and maybe the bottom line. If the Caribbean Basin Initiative was there to help the Caribbean, then why now is it such a boon to the Europeans? Why is it such a benefit to these companies that frankly are not creating jobs in the Caribbean as we had hoped? That, I think, is the matter of principle, even beyond the economics of the market.

Mr. ANTHONY. Mr. Chairman, I'd just like to make two quick comments about that.

It's my understanding that there will be at least three, and possibly more, letters submitted for the record for the committee members to read, from domestic purchasers of ethanol who state that the domestic industry is not currently able to supply their total

ethanol needs. So, at a time when the domestic industry cannot meet the domestic market demands for ethanol it is asking that Congress provide relief, by limiting imported ethanol. I find this to be a very strong contradiction in economic terms.

And in terms of continually trying to raise a red emotional flag by suggesting that the originol concept behind the treatment of ethanol in CBI was to enable a wine passthrough, flies in the face of reality. No. 1, there is no loophole. Customs issued its ruling to these companies before they invested one single dollar. Congress grandfathered these companies in because they had invested millions of dollars in planning equipment based on a legal ruling issued by Customs and upheld by the courts. So, there is no loophole.

Furthermore, the wine supply issue is addressed very thoroughly in the GAO report. Their conclusion is that the Caribbean countries cannot depend for certainty upon this European supply. So, at a time when the domestic industry uses the wine supply issue as a political red flag, independent fact finders have stated for the Congress that there is no certainty that such wine is going to be made available, and even if it were, they would not be able to use all of it. The numbers in the GAO report reflect a potential availability of only 32 million gallons.

With a 15-percent loss of volume from dehydration, the magnitude of the wine issue is only 85 percent of the 32 gallons. I believe this is something that you would certainly want to take into consideration.

I've told Mr. Durbin this. I've told the domestic industry this. I am not for a passthrough, but even in the original Caribbean legislation, we acknowledged that these countries do not have the ability to produce all products, and as a result, placed a requirement for a percentage of value while allowing for some passthrough. We did put a limit on the amount of passthrough allowed though, and I believe we should continue to apply this requirement to ethanol.

Mr. DURBIN. Mr. Chairman, I might add that I think there's a great potential for domestic ethanol production in the United States beyond the present capacity, the present manufacturers. But there is a real damper on the expansion of this industry so long as this issue remains unresolved.

We tried in the earliest days to set up a feedstock requirement that was reasonable, that would say to the people who wanted to use our duty-free provision that "you will use indigenous feedstock, create local jobs, and over a schedule reach a point where, in fact, you were helping the Caribbean economy." They chose not to do so, and as the International Trade Commission found, they are relying almost exclusively on this surplus European wine. That's helping, in the minimal fashion, the Caribbean nations.

Chairman GIBBONS. But didn't Beryl state in his testimony relating to the 1986 amendment that everything that has been done in the Caribbean has been done legally. The owners of these plants had gone to the Customs Service and had gotten a formal written ruling. You have gone to court and challenged them. You lost there, so you came back to the Congress again.

They met the value added requirement that was required of all Caribbean products; but for the U.S. ethanol industry, that wasn't

enough. You have this huge Federal subsidy to begin with, and then you couldn't abide by the same rules that all of the other American industries abided by, and that's why we got into the position of adopting the 1986 amendment.

As the GAO and the ITC reports say, the CBI ethanol industry will have to close down if it has to live by the 1986 amendment. Write it off.

Mr. DURBIN. Mr. Chairman, that may tell the story. If, in fact, you cannot produce ethanol, substantially produce ethanol in the Caribbean, then maybe we have our question answered here. I think the potential is there.

Chairman GIBBONS. The 70-percent domestic requirement is more than we impose on any other industry there.

Mr. DURBIN. But if we are really seeking to give to the Caribbean an economic incentive at the expense of the American taxpayers, should we step away from that and say, "for this product, we are going to create an exception?"

Chairman GIBBONS. The general rule—not the exception—the general rule is that all Caribbean Basin products must contain at least 35 percent Caribbean origin material; 70 percent is twice 35, as I recall.

Mr. DURBIN. What we're trying to do with the schedule, incidentally that was agreed to by the ethanol producers at the time, is to force them, through a schedule that they agreed to, to come to the conclusion that it was going to be an indigenous industry. They fought us ever since they reached that agreement.

Chairman GIBBONS. Yes, but I don't know of any other industry trying to raise the limits. I've got a lot of producers in my State that are directly competitive with the Caribbean—the citrus people, the flower people, the horticultural people—just about everybody in my State is competitive with the Caribbean. They are all willing to live with the 35-percent requirement.

Why isn't your industry willing to go with 35 percent?

Mr. DURBIN. I think the whole question of 35 percent can be addressed by some of the later witnesses in terms of the technicality of it, but it is our conclusion that this dehydration, this simple dehydration process with European wine hardly reaches the 35-percent figure.

Chairman GIBBONS. That wasn't the conclusion of the court nor was that the conclusion of the administration.

Mr. DURBIN. I might say to the chairman that there have been so many assaults on the Caribbean Basin Initiative by those who would seek to export ethanol to the United States duty-free, whether it's the inclusion of toluene or other additives that it is difficult to simplify this into one conclusion by the court which would apply to all instances.

But what we have with the ITC study is a clear statement where 68 percent of it is being used—they are using, rather, European wines coming into the United States. I think it's very clear what this unfortunate loophole is being used to do, and it isn't to help the Caribbean countries.

Chairman GIBBONS. Are you afraid the use of European wine will expand?

Mr. DURBIN. I don't see any reason why it wouldn't. Frankly, if this committee doesn't come to the conclusion that we are going to try to close it in some respect, I think you'll find a burgeoning industry for surplus European wine, but I don't think it will be, as I mentioned earlier, to the benefit of the Caribbean countries as it could be.

Chairman GIBBONS. All right.

Mr. Russo.

Mr. RUSSO. I want my friend Dick Durbin to know that at least someone on this panel agrees with him, and not with Beryl. [Laughter.]

I guess the question that I have for Mr. Anthony and Mr. Durbin, is what the original intention of the exemption was. The intention, as I understand it, was to give the dehydrators the assurance that they could have time to expand dehydration facilities and go to full fermentation, that eventually they wouldn't have to use this wine alcohol, that they needed time.

So, we gave them that opportunity, and if you check the record you will find letters written by the various companies that said, "Just give us time. We're going to go to 100 percent CBI source feedstock by 1990," when they've never done that.

Talk about 3 percent. That's not the potential. You have an 800 million gallon operation going nationwide and the potential in the CBI's, as I understand it from reading the reports that you cited, is a 215-million-gallon capacity.

So, it could be almost 25 percent of the marketplace. The question is, did we in Congress intend that the CBI get such a break that they're allowed to go out and create what is a sham, in my opinion, that is the ability to take wine from Europe. We said to the CBI, "We want you to create jobs, and we realize that you may not be able to do it initially, so you figure out how to use this wine alcohol that's heavily subsidized in Europe—we need you to help the European agricultural industry, so you go ahead and do that and bring it through the CBI, because then we'll kill two birds with one stone. We'll help you and we'll help the Europeans and the taxpayers of this country and the local industry will pay the price for it."

I don't think that's what the Congress intended to do, as I recall those meetings. Basically, we said we're very concerned about pass throughs, and we set various requirements that they had to meet, and now they don't want to meet those requirements. Why? The GAO report says they can't do it unless they use European wine alcohol. Is that correct as I understand it, Beryl?

Mr. ANTHONY. No, not exactly. Actually, the GAO report says that the Caribbean industry cannot depend upon the wine market of the EC countries for future feedstocks, and I would refer you to pages 29, 30, and 31 because here is our independent——

Mr. RUSSO. How do they plan on doing it if they are not going to use European wines? What are they going to do with the other 70 percent? How are they going to do it?

Mr. ANTHONY. Well, it's going to take a combination.

Let me back up and see if I can answer your question in a logical fashion. One, the Caribbean Basin Initiative was an effort by the United States of America to try to encourage trade, not aid, busi-

ness economic activity and not welfare to the Caribbean countries. I agree that that was our stated purpose, and I would agree that when we first discussed this initiative, no one conceived of the possibility of buying contaminated wine stock from some foreign non-COI country, and forever and a day dehydrating it and operating ethanol facilities in the Caribbean. Nobody considered this possibility. At that time, that particular market source was not even available.

So, what do we have now? What I see, Marty, is weighing the demands of the domestic industry versus trying to live up to the spirit of helping the Caribbean countries, and we need to try to analyze this from a factual standpoint.

GAO says this. They say that the Caribbean ethanol manufacturers cannot rely upon the European wine market and list the reasons why. No. 1, it's who owns it. It's in private hands. Some of it's in State hands, and they give an estimation of how much reasonable might be expected to come from wine European stock.

It only amounts to about 32 million gallons per year, as I understand it. Then if you go back and look at the total capacity that now currently exists, the total effective capacity is only 88 million gallons per year. The total design capacity is 212.

I understand that the domestic industry is 850 million gallons a year, and if Mr. Durbin is correct, and the potential is there for the market to increase, then it appears to me that this is a golden opportunity for the Ways and Means Committee to make a rational decision whereby both the Caribbean countries and the domestic industry can benefit. If the market increases and the demand exists, it appears to me that we ought to allow these countries to participate some in that growth.

And I would just close by saying that if you look at the imports in 1985, 1986, 1987, and the first half of 1988, the volumes that come into this country just will not sustain an argument of harm to the domestic industry.

Mr. RUSSO. Dick, I'll give you a chance at that before I go.

Mr. DURBIN. I think it is interesting that Beryl and I have read the same reports and come to opposite conclusions. But the International Trade Commission report is very clear that the basis for the export of fuel ethanol from the Caribbean is one product that's contaminated surplus European wine, highly subsidized. And without that, there's no industry.

Whereas we started this discussion in the early days of the CBI with the idea of building a local fuel ethanol industry in the Caribbean. We are now being told by those who are in the business in that area that they are going to eventually reach that. But, for the time being, they want to use the subsidized European wine as their feedstock.

We've missed some golden opportunities, and I think to the detriment of the Caribbean and to the detriment of those who argue that the Caribbean Basin Initiative was, in fact, a way for the United States to provide a helping hand.

I just don't see a rationale for building that industry based on European wine at the expense of American taxpayers.

Mr. RUSSO. Well, isn't it—you know, one of my concerns is that basically they are using the European wine to lower their costs so they can come in at a lower cost than we can make it here.

As I understand, they land at about 17 cents cheaper. You can correct me if I'm wrong. But if they can't make it without that backdoor subsidy, who says the Congress has to guarantee them a percentage of the market.

I think a decision was made that we want to stimulate local employment, we want them to use indigenous feedstocks, and if you can't do that, then go in another business.

No one says we have to guarantee the Caribbean Basin part of our ethanol market. I mean I understand the problem. Sugar prices, they can't do it the way the sugar prices are now and because of the price of gasoline.

So if sugar prices go down, it becomes more profitable for them. Gasoline prices go up, it becomes more profitable for them. We can't control the marketplace and how those prices move. I don't think we ought to be in the business of doing that. I want to encourage trade with the Caribbean countries but, at the same time, I don't want to encourage sham operations.

Mr. ANTHONY. I have a hard time believing then when Customs gives a legal ruling and a court of law upholds that ruling, that you can classify that operation as a sham operation. And that is——

Mr. RUSSO. That's because I don't agree with the court. It's easy for me. I don't agree with them, they don't agree with me. So I call it a sham and they say it's legal. The bottom line is I get to write the law.

Mr. ANTHONY. I get to help you.

Mr. RUSSO. Right. [Laughter.]

Mr. ANTHONY. Well, I think what we are looking for here is fairness to both parties. And that's one reason I have consistently disagreed with the compromises that have been forthcoming. I have never, from day 1, agreed to any one of the compromises. While some Caribbean countries and their representatives agreed to the compromise, I've been on record from day 1 saying that this agreement is not one that they could live up to.

The only case against the Caribbean ethanol industry that the corn growers and the domestic ethanol industry can, in the long run bring to the Congress is that some spoiled wine is imported into the Caribbean, is processed, and then brought into the United States. Yet even the merits of this argument doesn't hold because despite this passthrough, the Caribbean industry still can't bring in volumes enough to exceeded 3 percent of the U.S. market.

My bottom line is this, if a domestic industry which is heavily tax subsidized, cannot compete against this 3-percent penetration, if you are talking about wanting to make a fight, we can just wait until 1993 when their tax subsidy expires and we can have a real fight on our hands because a single domestic company received over a $20 million check from the U.S. Treasury for the subsidization of the production of ethanol.

I've got a lot of folks in my district who would love to get a $20 million check directly from Treasury for a subsidization of ethanol. So I think there is a lot of greed, and maybe misspent priorities on

both sides in this case. But let's examine the facts: the average U.S. ethanol price per gallon is $1.06 to $1.08, (1987-88); average U.S. cost of productions is from 57 cents to $1.08 per gallon depending on the price of corn.

Mr. Dorgan can tell you how the price of those agricultural products fluctuate, depending on how their raw material stock is doing today.

I would propose that you establish a reasonable domestic contract requirement for the Caribbean countries. I think 75 percent is intolerable, and they'll never be able to live up to it. Yet if this becomes the final recommendation of this committee, then you will be creating the demise of a domestic industry—one which was legally established, in which a great deal of dollars was spent and which has undisputedly, provided economic activity to this region in the form of jobs.

So, Marty, I don't think our positions are necessarily that far apart.

Mr. RUSSO. What do you think is a fair percentage, Beryl?

Mr. ANTHONY. Well, personally, I think that 35 percent would be fair.

GAO has made two or three recommendations, and I would say a couple of their recommendations seem to make a great deal of sense, one that I think the CBI could live up to and probably the domestic industry could tolerate.

Mr. RUSSO. Well, let me just close by making this comment to my colleague.

If I am going to subsidize anybody with tax dollars, I would just as soon subsidize a U.S. company than a firm in a foreign country.

I would like to help the Caribbean. But we are trying to also help them grow and expand in trade jobs down there. And I don't think the dehydration process right now creates the jobs they need. Maybe 35 is too low and, obviously, maybe 70 is too high, and there is some number in the middle that we can live with.

Thank you, Mr. Chairman.

Chairman GIBBONS. Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman.

I would like to relate what I think is the purpose of the CBI initiative. It isn't to subsidize foreign countries. It is to keep these countries democratic, to keep them strong because, strategically, they are important to us in terms of our overall national interest.

It is not a question of subsidizing ADM as opposed to Jamaica or one of the other countries. It's a question of making sure that our national security is protected by making sure those countries that surround our waters are secure and strong.

Everyone knows the situation in Jamaica right now in terms of the new leadership and the economic problems they're having. And they have long been a stable democracy, along with Costa Rica and other democracies. At the same time, we know how fragile democracies are.

And so I think when President Reagan, in 1981, talked about the CBI initiative, he was talking in terms of the U.S. global self-interest, and not so much the interest of the Caribbean countries themselves. But it's in our interest to make sure they remain strong and viable.

I would like to thank both Beryl and Dick for their testimony today and speak about a couple of issues.

Certainly, I agree with Beryl's comments, Dick, and I tend to disagree with yours. But what's really troubling to me, and I wish that this panel would have had somebody from ADM, perhaps their chief financial officer appear before us, is that over a 5-year period, the U.S. Government subsidizes ADM to the tune of $4.494 billion.

Also in the 1986 annual report of ADM, they make the statement, "Our acquisition of oilseed processing plants within the European Economic Community enables us to buy for processing heavily subsidized soft seeds like rapeseeds and sunflower seeds, as well as soybeans, from Brazil, China and the U.S." This ability to more advantageously source raw materials and better serve the foreign markets enhances their global trading position.

So, they are playing hands themselves. It's very troubling that a company with 40 percent of the market wants to keep out 3 percent of the market. I think the potential for the ethanol market to expand is significant, and I think it's also interesting, Dick, that the Texas Corn Growers Association——

Mr. DURBIN. Which, incidentally, I might add, Bob, you will find to be an exception to all of the corn growers across the United States.

Mr. MATSUI. Well, maybe they've seen the light.

Mr. DURBIN. Maybe.

Mr. MATSUI. They've indicated that ethanol is in very limited supply in this country right now, and it's widely known that the largest U.S. producers cut back production early this spring, and that there are several smaller producers that are either not producing or have the markets served by the largest producer.

I know this is happening in California. We periodically have shortages of gasohol, and that's why we can't expand the market. There is so much uncertainty with gasohol that people are reluctant to invest in it. Frankly, I think, it's in your interest and the interest of your region that we allow some competition so the markets can expand instead allowing one or two producers control the market by keeping it small. I think it's really against the interest of the domestic industry.

I'm not going to ask you any questions now because you know where I am and I know where you are. For the life of me, I can't understand the logic of those that oppose them. I think what the Chairman says is entirely correct: we should treat this product the same as we treat other products coming from the Caribbean countries. The 35 percent value added requirement is something we all agreed upon to compromise. I think it makes all the sense in the world to maintain that.

No further questions.

Chairman GIBBONS. Mr. Pease?

Mr. PEASE. Thank you very much, Mr. Chairman, and thanks to both of our colleagues.

Unlike Mr. Matsui, Mr. Durbin, and Mr. Anthony, I do not have an established a position. I'm a seeker after truth.

I'd like to pick up on the point that Bob Matsui raised a minute ago. When the original CBI was established, the 35 percent value added requirement. made sure that there really was some assist-

ance to the CBI nation and that we weren't just passing things to whatever that product might be.

As I understand it, this requirement applies only to ethanol, not all the other products coming in, and I'm reminded by Dick Darman that if it walks like a duck and talks like a duck, it looks like protectionism to me—Mr. Durbin, what is the rationale for singling out ethanol? If the idea is that we really want people to benefit to the maximum so that all of the feedstocks remain local, why wouldn't we do that for every product?

Mr. DURBIN. Don, what I think we found early on, and I might agree with Marty Russo on this comment, I didn't concur with the court's decision or the conclusion as to whether or not there was a substantial value being added in the dehydration process.

But, I think what we found early on is that if we didn't staunch the flow of European—subsidized European wine through this market, that we would, in fact, discourage the creation of a full fermentation industry in the Caribbean.

I can recall early debates on this meeting with some of the representatives of companies which will testify for you today, saying to them the CBI was designed to help the people in the Caribbean. We can see that it's helping your company. We can see that it's helping to deplete this resource of European subsidized wine. How is it helping the Caribbean?

In 1986, after a long period of negotiations, we came to an agreement. There was an agreement, and the agreement suggested that over a period of time we would gradually increase the feedstocks. We would build this indigenous Caribbean industry starting with 30 percent and moving up to 75 percent in 1989. That was signed, sealed, and delivered, and the net result of that, had it been followed by the companies which entered into it in good faith would be, in fact, an indigenous industry.

Now, if I might refer back to some of the comments made earlier by Bob Matsui, I think it is an overstatement to suggest that the company in my district does not come to this process with clean hands. They have followed the law. It is true that they have benefitted from the law, but I can argue as well that the American economy has benefitted. We have reduced the expenses of our farm program. We have increased the demand for our corn products. We have created an industry in the United States that I think will ultimately be used to your benefit in California and across the nation to abate air pollution, and we've reduced dependence on foreign oil.

Those were the four objectives of the exemption as it was originally created. The fact that a company has availed themselves of those exemptions and achieved the goals that we set out in the legislation, doesn't strike me to be sinister in any way. It is open, and I don't think it's a question of clean hands.

I honestly believe that from their perspective, though, Don, that if this were truly Caribbean fuel ethanol coming into the United States through the CBI, we wouldn't be here testifying because we would be saying in fact it is competition as it should be. Give them the same excise tax exemption. Let them send it in duty-free so that they can benefit from them. Let them create their markets in the United States.

But when we see these corporations coming together, springing up over night, taking advantage of the surplus European wine to take advantage of CBI, we cry foul. Sometimes the courts agree with us, sometimes they don't.

Mr. PEASE. Is the company you're talking about Archer Daniel Midland?

Mr. DURBIN. Yes.

Mr. PEASE. So, what you're saying——

Mr. DURBIN. It's certainly the largest producer. There are certainly others.

Mr. PEASE. And what percentage do they supply——

Mr. DURBIN. I don't have that figure.

Mr. PEASE. What's the percentage?

Mr. ANTHONY. They have 60 percent operational capacity on the domestic market.

Mr. PEASE. So, according to what you're saying—what they're really seeking, then, is protection from the European wine market. Is that right?

Mr. DURBIN. I'll let them speak for themselves. I'm not here speaking for them. I haven't been briefed by them and I don't come in with any statement by them.

What I am seeking, as a person who lives in an area of the country where a lot of corn is being grown and where this product is essential to the income of our local farmers, is to have a fair shake when it comes to the importation of this fuel alcohol. If it is a pass through for European wine alcohol, I don't believe that that was our original intent. I think a lot of smoothies are going to make a lot of money out of it, but I don't think it will help the Caribbean.

Mr. ANTHONY. Would the gentleman yield?

Mr. PEASE. Surely.

Mr. ANTHONY. Just to try to clarify the point you were trying to make, Don. Now, the Caribbean Basin Initiative legislation was passed in 1983, and we granted duty-free treatment for products from the CBI countries with the 35 percent value added. Ethanol was not among the original list of articles exempt from duty-free treatment because of import sensitivity.

As a result, this industry was able to penetrate a whopping 3 percent of the domestic market. Well, section 423 of the 1986 Tax Reform Act established these additional restrictive requirements for only one product, ethanol. Now, you know (why I objected) at 2 on that Saturday morning. I didn't think we should be doing trade on a tax bill; trade issues ought to be handled in a trade bill. Yet, I didn't have the votes. Seventy-four percent of the domestic market is contained in the midwest, and the midwest had the votes (30 percent local feedstock by 1987, 60 percent by 1988, and 75 by 1988).

Because there was a change in the middle of the game by the U.S. industry, the Caribbean producers are now coming in here and asking for some relief. I agree with what Dick says. You need some stability to the market, but you need stability both ways. You'll not have the local industry expanding until we have a clear cut resolution of this issue, Mr. Chairman. At the same time, can you imagine anybody going into the Caribbean countries and trying to invest in any kind of an ethanol plant under today's legislative climate? It's just not going to occur.

This is why this hearing is so important, and I hope that the committee comes to some rational conclusions so that the domestic industry can continue to survive and be strong, and at the same time, we don't shut down the economic possibilities for the Caribbean countries.

Mr. PEASE. Mr. Chairman, our friend Dick mentioned a minute ago that he would let the company speak for itself. Have we ever had testimony from the company? Were they invited to this hearing?

Chairman GIBBONS. Did we invite them? Yes, sir.

Is anyone here from Archer Daniel Midland?

[No response.]

Mr. PEASE. If ADM has such a large percentage of the total ethanol capacity, I think it would be helpful if at some point the subcommittee could hear directly from the company about its own interest in this area.

On another matter, some reference has been made to the CBI countries having agreed to the higher percentages?

Mr. DURBIN. No, I'm sorry if I made that representation because it's my understanding that the companies, particularly the ones that were being challenged through some of the court cases and hearings—I can recall in particular one of the companies; it will be represented today—testifying saying, "Let me tell you what we've got in mind, Congressman. We own a sugar plantation down there. We're going to take this cane sugar, in the Caribbean. We're going to show you a full fermentation facility. Now, we know that it costs ten times more to build that than it does for these dehydration facilities, but we're prepared to make that commitment. That's what CBI is all about. That's our commitment to the Caribbean."

"So we have no objection to increasing this percentage of feedstock. That's consistent with out corporate objective." No sooner had they walked out of that room from the agreement that we implemented a law, and they came in and started crying foul. "This will never work" they say. It's just not practical. It's not feasible, and they found a lot of willing ears here in the Congress who started talking about changing it.

And that, I think, is the reason for some of the frustration I have today that they want to continue this process of using this European wine after making promises in 1986 to the contrary.

Mr. RUSSO. Would the gentleman yield?

Mr. DURBIN. Yes.

Mr. RUSSO. If I'm not mistaken, too, Don, the reason they were given the grandfathers was to provide them time to go to full fermentation.

If anyone was misled, it was the Congress because we relied on their statements that they would ultimately go to full fermentation. That's why the waivers were granted again, and the reason there is resistance today is that we're no better off than we were when we granted the waivers.

Chairman GIBBONS. Excuse me, may I interrupt just a second here?

I'm having a hard time figuring when the waivers started. As I recall, the original law was that any product that contains 35 percent Caribbean value added, were eligible for duty-free treatment.

There were no exceptions, that rule applied to every product. It had to have at least 35 percent. The people who set up these ethanol plants apparently thought they were getting 35 percent value added in the Caribbean. They went to the administrative agency and got a formal ruling that they met the 35-percent test. That ruling was appealed. The court sustained the ruling, and then the Congress started changed the law.

That's the way I recall the facts. Am I correct in that?

Mr. RUSSO. You're correct, sir.

Chairman GIBBONS. And then, in the middle of the night in 1986—that was a famous time—but in the middle of the night in 1986, that's when we started changing the law; and we got up to as much as a 70 percent domestic content requirement for ethanol alone—75 percent.

Mr. ANTHONY. 75 by 1989, Mr. Gibbons.

Chairman GIBBONS. Yes.

That's also when the waivers started, and as I recall we hadn't had any hearings or anything else. Did we have any hearings?

Mr. ANTHONY. No.

Chairman GIBBONS. Had we had any hearings?

Mr. ANTHONY. No, sir. There were no hearings on it.

Mr. MATSUI. Mr. Chairman?

Chairman GIBBONS. Yes.

Mr. MATSUI. I think your representation of the facts is absolutely correct with the exception of one company, which was Tropicana, which received a grandfather. None of the other Caribbean companies actually appreciated what we did in the 1986 bill either. So, it's difficult to suggest that they are now reneging on an understanding because they really weren't privy to any of the discussions that were going on. But, apparently, they were against it except for the one company. So, I find it hard now to suggest that they have to play by the rules, when they, in fact, adopted it.

If I may, Mr. Chairman, Mr. Pease——

Mr. PEASE. I'm being gracious.

Mr. MATSUI. You can't have full fermentation—and I acknowledge that in all cases—because much depends on the price of gasoline, the price of sugar. There are a lot of variables, so you have to give these countries some flexibility so they will be able to maintain their operations. No one is going to invest in these countries if they find rigidity. I'm afraid that's what would happen if we allowed the current law remain in effect.

Mr. DURBIN. Would the gentleman from Ohio yield?

Mr. PEASE. Surely, go ahead, Dick.

Mr. DURBIN. I might add in following up Mr. Matsui's comments, nor would you have any company willing to build a full fermentation facility in the Caribbean at the expense of $35 million so long as we create a climate where dehydration tower for $2.5 to $3 million can accomplish the same thing, and perhaps turn out an even bigger profit for you, they're not going to use local feedstock. We have created a pass through that's a money maker, and they are not going to move to full fermentation as long as we allow this loophole to continue, and that was the reason why the feedstock requirement was to be increased.

I will concede that Tropicana was the lead negotiator in this 1986 agreement, but there were other companies following this process as we went along, and whether or not they signed on the dotted line, that I couldn't say. But it wasn't an exclusive negotiation between Tropicana and those of us who were interested in promoting the growth of ethanol in a responsible way.

Mr. PEASE. Could I ask you about the 3 year adjustment period? It appears to me that that's a little on the short side for the countries. I understand that some of these countries have to bring the cost of their sugar cane production down by mechanization and that sort of thing. To make sugar cane competitive as a feedstock under 3 years is a little on the short side for doing that. The 3-year period would be advantageous to the domestic company, Archer Daniel, because it would protect them that much sooner from Caribbean competition.

Does anyone know why the 3 years was selected in the first place, and whether that is a reasonable period given the circumstances?

Mr. DURBIN. Tropicana said it was realistic. They could do it. They wanted to do it. They were going to put themselves to the task of creating this indigenous full fermentation process and put the people in the Caribbean to work. We took them at their word. That's what the CBI was all about.

Mr. PEASE. The Tropicana representative was speaking for the other companies in the Caribbean or for a nation in the Caribbean?

Mr. DURBIN. At the time they made a lot of representations. I can't relate to you now with any degree of certainty all of the things they said.

Mr. ANTHONY. Don, I think you have to weigh the compromise against what the original proposal was. The original proposal was to eliminate imports of CBI ethanol, effective immediately at 2 Saturday morning.

We were under the tight timeframe of markup, trying to report out a bill we had been working on for approximately 2 years. The chairman just didn't give us the greatest amount of time for negotiating on all the details of the compromise. I happen to know just enough about the manufacturing process, how long it takes to order equipment, and have been to the Caribbean enough times with the Ways and Means Committee on fact finding missions to know from day 1 that that particular compromise could never be lived up to.

But the main objective of that one particular company was to buy some time so that they wouldn't be shut out of business that night. They made a bad deal. As a representative of their interests in the negotiating process I told them it was a bad deal, and I tried to defeat it. I offered an amendment to strike it, but lost the vote in the full committee.

I don't think the entire congressional membership was aware that we were legislating trade policy which impacted only one commodity in a tax bill, and that's the reason this hearing is so important. Obviously there will be other witnesses who will follow our testimony and will represent the domestic industry, and then the Caribbean industry. After their testimony you'll have a much

better feel for what is feasible and what is not feasible in terms of feedstock requirements.

But you cannot expect the ethanol manufacturers to get every single piece of cane or sugar—raw sugar—that is produced in the Caribbean countries because there are competing interests—the Rum industry, and for export. So you must determine what is reasonably available in the open market. Again, the GAO's report will tell you that CBI producers cannot even rely upon a guaranteed percentage of the domestic sugar market.

So, if you impose too strong a restriction on these producers, you will be, in effect, legislating them out of business. I'm not here arguing for a zero percentage requirement, but I'm certainly here arguing against 75 percent. I would request that the collective wisdom of the committee prevail and preserve the ability of these producers to stay in business.

Mr. RUSSO. Don, if we can get some information to you, one of the companies Chemical Fuels Corporation, as I understand it, to the House Trade Subcommittee that CFC's distillation facility would be operable around April 1, 1986, that they would have to dehydrate imported alcohol while the fermentation plant was under construction, and the entire A–Z fermentation facility will be completed by the end of 1986.

So, reliance upon that waiver was given.

Let's go to Allied Ethanol Fuels. In May of 1988 they announced that they would begin production at a 42 million gallon capacity at the Grand Bahama facility in June, in the meantime 20 million gallons were exempt. The CBI counted requirements that it would ferment its own alcohol locally to meet this 60 percent requirement for the remainder of its production.

So, they knew what they were getting into, and they were prepared to do it. Petrojam, which is owned by the Government of Jamaica, also stated that the Government of Jamaica and Estate Controlling Petrojam is committed to the development of a fully-integrated ethanol project that would eventually utilize 100 Jamaican feedstock. They weren't surprised by anything. They knew exactly what they were doing. You can't do it.

I'll agree with Beryl, and I'll agree with the report. You can't do it at 75 percent. Does that mean that you have to do it? It means that you need to find something else to do.

Mr. DURBIN. Would the gentleman yield?

Mr. RUSSO. Yes.

Mr. DURBIN. If I might add too that Tropicana wrote to the Ways and Means Committee, its Subcommittee on Oversight in March of 1986 proclaiming Tropicana's objective of using 100 percent CBI source feedstock by 1990. Specifically claiming that Tropicana would build a fermentation and distillation plant in Belize to use locally produced molasses and surplus sugar, hopefully to be commenced by the 1987–88 cane season, and obtain a rum distillery in St. Lucia to produce alcohol from CBI molasses beginning with the 1986–87 season.

We're dealing with representations made by the companies. They are here crying foul.

Mr. PEASE. Thank you, Mr. Chairman.

Chairman GIBBONS. Thank you for your generosity, too.

Mr. Dorgan, would you like some time?

Mr. DORGAN. Thank you, Mr. Chairman.

Let me observe, first of all, there is a lot of revisionist history about the 1986 Tax Act and what happened in the early mornings. And I think—it is my observation of what happened in the early morning hours in 1986 with respect to CBI and the production of ethanol was that it was clear back then what was going to happen to us. We are going to have some financial operators, many of them non-CBI, purchase some subsidized products in Europe, Brazil, or elsewhere, run then through the Caribbean and move it through this country, and it was going to create no jobs in the Caribbean to any great extent.

I think because of that people said, "wait a minute, this is a sham, let us do something that would try to provide incentives for more jobs in the Caribbean."

Now, as I've listened to this argument, I find it interesting, because I think the entire argument has been inverted here. The issue, it seems to me, is not what is a domestic subsidy or who is the domestic producer we are trying to protect here. The question is what were we trying to affirmatively do in the CBI? That is the question. What was our goal with CBI?

And I recall my friend, Mr. Anthony, sitting next to me on the Floor of the House and standing up to speak and he said then exactly what he said today, he is consistent. What we want to do is to create some jobs in the Caribbean. That is the purpose of all of this. We want to create jobs in the Caribbean.

Mr. Durbin's point is that as long as you allow someone to run cheap, European wine alcohol through a Caribbeam drying tower and then into this country, why on earth would anyone build a full fermentation plant and create jobs down there?

So I guess the question, Mr. Anthony, is this. Isn't what you are proposing and isn't what you are supporting exactly counter to what you were arguing for in the passage of CBI? This does not create jobs. In fact, it creates money for some folks. And some of those folks are not even from the Caribbean. But it certainly does not create jobs.

Full fermentation plans would create jobs if in fact we want to try and provide incentives for the development of full fermentation plants in the region. So how do you reconcile the position you now take with the proposition that we really want to affirmatively create jobs in the Caribbean?

Mr. ANTHONY. It is a fair question. And I do not believe I have taken an inconsistent viewpoint. No. one, the dehydration plants do create employment and they do earn foreign exchange for those countries. All dehydration plants are capital investments, maybe smaller than a full fermentation plant, but you still have to put capital——

Mr. DORGAN. But not maybe. I mean we are talking about minnows versus whales here. I mean, these are very small investments versus very large investments of a full fermentation plants.

Mr. ANTHONY. Other witnesses will testify later this afternoon and will tell you the exact dollar cost. I do not know what the dollar cost is, but for argument's sake let us say $10 million versus $100 million. A $10 million investment in Kingston, Jamaica is on

a par with probably $500 million investment in North Dakota or Arkansas. So you have got to look at it in terms of the relativity to their economic scale.

Although the Customs—although none of these companies pay Customs duty, most of them do pay taxes on local purchases and salaries of the employees in the CBI countries. The dehydration plants directly employ between 25 and 40 persons—many of whom are college educated—as well as maintenance, security, seaport, and other contract personnel. The college educated receive very high salaries when compared to the others on those islands.

The companies use and pay for local goods and services, and they also provide revenue for local port authorities. So it is not fair to say that the dehydration facilities do not create jobs and do not create economic activity in those regions. They do.

You know—let me just close by addressing the issue of whether or not these people made a good or a bad deal 2 or 3 years ago, under the stress of trying to reach a legislative compromise. I do not think any of them shall be held to any written statement or to any written agreement. The chairman of this committee has many times said that we are the court of appeals, and, therefore, if we find something wrong, we certainly ought to try to correct it.

What I am saying, Byron, is that a 75 percent local feed stock requirement is intolerable, and I believe it will run them totally out of business. There certainly should be some level of local contract requirement in some range at which the domestic industry would not be harmed and yet would preserve the full spirit of the Caribbean Basin Initiative number 2.

Mr. DORGAN. And my point is that the spirit was to try to create opportunity in the Caribbean. You and I have been to many countries in the Caribbean. You see the cane fields down, unemployment rampant. And many of us would like to do whatever is available to be done to create opportunity in the Caribbean.

It seems to me that it creates very precious little opportunity to provide only a few jobs, in most cases for dehydration towers, at least in many cases, owned by non-CBI investors, in order to bring in cheap, subsidized European wine alcohol to move to the United States.

I mean that does not even seem to come near the spirit of what I heard you and I and others talking about on the floor when we passed CBI. And if there are things affirmatively we can do that would say to these countries, "we want you to build full fermentation plants, and we want to do everything we can to help you build those plants," if that is the goal, then count me in. But if the goal is to say that a few jobs in dehydration plants are sufficient for us so that we can be a conduit to get cheap, European wine alcohol into this country and make some other folks outside the region pretty rich, that makes no sense to me at all.

Chairman GIBBONS. Will the gentleman yield?

Mr. DORGAN. Sure, be happy to yield.

Chairman GIBBONS. The law—not the spirit of the law, but the letter of the law—was that any product that came out the Caribbean had to have 35 percent Caribbean value added; and then that product—with some exceptions such as textiles, garments, and tuna—could come in here duty free.

If I am wrong, somebody correct me. The administration found that those dehydration plants met that test. There was skepticism about that. A lawsuit was started. The court ruled finally that the plants met the 35 percent test.

Now, why then are we concerned about all these other "spirits" of the law? The law is what it says it was. It applies to everybody else. It applies to my flower growers, my citrus growers, my ornamental plant growers, my—who knows what other growers down there. If I applied to this law what you are applying to this law, I would be in here asking for exceptions for citrus, exceptions for flowers, exceptions for ornamental plants and all kind of vegetables and everything else.

It looks to me as if we have a case here of the Caribbean having been a little successful and made a 3 percent penetration of an industry, and the industry says, oh, we cannot stand 3 percent.

Mr. DORGAN. Mr. Chairman, Mr. Chairman, let me ask this question——

Chairman GIBBONS. That is what it sounds like to me. Am I wrong?

Mr. DORGAN. Yes, I think you are wrong.

Chairman GIBBONS. All right, well where am I wrong?

Mr. DORGAN. Well, I do not know of anybody in the U.S. Congress that when CBI was passed would have stood up on the Floor of the House and said, Mr. Gibbons or Mr. Anthony, we join you, we really want to help the Caribbean, we join you, and what we want to do with this is to allow the Caribbean to bring in a deeply subsidized European product—I am not talking about a European product, I am talking about——

Chairman GIBBONS. As long as it met 35 percent.

Mr. DORGAN. But I am not talking about just any European product. I am talking about a deeply subsidized European product. We are not willing to allow a Caribbean outfit to bring in 80 percent or 70 percent or 60 percent of a deeply subsidized European product and be the conduit to get that subsidized European product into America.

Now, understand the EC—as the Chairman well understands, the EC is involved in all sorts of finagling in sugar, in oil seeds, in dozens of areas. We have got real serious trade problems with the Europeans. And if somebody had made the case to me when we talked about CBI or to Mr. Russo or anybody else, that what we are really saying here is we will allow—under the 35 percent, we will allow something extraordinary to happen. We will allow them to take a lake full of wine that is deeply subsidized, run that through the Caribbean, and that is fine with us. That would not have been fine with anybody then.

And the fact that we passed the law and come back and make a future test necessary because of those subsidies and the inequities we see is nothing that is out of context to what we should be doing. We did in 1986 what we should have done in 1986 in the middle of the night or whenever we did it because we understood what was going to happen.

We had some dehydration towers on a ship down in Miami I believe at the time that was ready to be the conduit to run some water out of some European wine. And people said, wait a second,

that is not what we are talking about for the Caribbean. We were talking about jobs.

Chairman GIBBONS. It is 35 percent in order to quality.

Mr. DORGAN. Thirty-five of a deeply subsidized product from Europe.

Chairman GIBBONS. 35-percent Caribbean value added to the product. That is all that the law has ever required. We debated that requirement in depth in the subcommittee. I think Mr. Pease will remember that because he wanted a higher one, and others wanted lower. So we came out at 35 percent. We did not say what the rest of the product had to be. It could come from anyplace. But it had to be at least 35 percent Caribbean in order to get the duty-free treatment.

Now, that is not the "spirit" of the law. That is the letter of the law.

Mr. DORGAN. And we changed that because we determined that the other 65 percent, if it was deeply subsidized, such as European wine alcohol, would represent something that we did not think was the right incentive. Why would anybody build a full fermentation plant—I re-ask the question—if we allow the current situation to exist? They would never build a full fermentation plant in the Caribbean

Mr. MATSUI. Mr. Chairman, will you yield?

Chairman GIBBONS. Certainly. I do not believe that I have the floor; I think Mr. Dorgan has the floor.

Mr. DORGAN. I will be happy to yield

Mr. MATSUI. Byron, if you feel that way—and I can appreciate your concern about the European wine being highly subsidized. I would imagine they feel the same way about ADM being highly subsidized by the U.S. Government. But that is another issue that we will probably address sometime in the future, as Mr. Anthony suggested—why do you not just have them file a 201 or a countervailing duty action? Let the ITC or the courts take care of it. Why bring it to this subcommittee?

Mr. RUSSO. Well, I think that may be the way to do it. And then we can keep the CBI clean instead of trying to drill holes in it through various sectors of the U.S. economy.

Mr. DORGAN. Well, I would accept that if the 201 process was any good. But it is not worth a nickel

Mr. MATSUI. You voted for the bill.

Mr. DORGAN. Which one

Mr. MATSUI. The last one.

Mr. DORGAN. Reluctantly.

I guess the point is, I find it difficult to believe that we should not legislate where we find appropriate in re-evaluating something like CBI. And we did find it appropriate in 1986 to come back and legislate largely because we felt—or at least many of us felt that what was going to happen down there was really a financial sham, more of a financial conduit for some cheap foreign goods to come in here, not creating jobs in the Caribbean, but creating some money for some other speculators.

That was the feeling back in 1986. That is why there was action in 1986.

Now Beryl, you might be right. Maybe 75 percent is not the magic number. I do not know what the magic number is. But I do know this: that our intention—I would hope I speak for all of us on this committee, our intention is to try and provide opportunity in the region. Opportunity means jobs in the Caribbean. And frankly, when other testimony is heard I think it will demonstrate the dehydration towers, honestly, Beryl, do not create a great deal of employment in that area. Full fermentation plants would.

Mr. PEASE. Would the gentleman yield?

Mr. DORGAN. Be happy to yield.

Mr. PEASE. I appreciate the gentleman yielding.

I guess I had a little trouble accepting that the primary motivation of those who got the amendment enacted in 1986 was to create more jobs in the Caribbean. If we are worried about——

Mr. DORGAN. Why would the gentleman have trouble?

Mr. PEASE. Because if we are worried about creating jobs in the Caribbean and keeping out cheap European wine, we should have made it 100 percent, not 75 percent.

If the problem, as you suggested, is really the unfairness of subsidized European wine coming in, then the 1986 amendment should have applied to upstream dumping, created that as an offense in the Trade Act, not this sort of rough solution of running up the percentage of domestic content.

Mr. DORGAN. Well, the Gentleman from Ohio understands that for 8 years we have had virtually no activity against upstream dumping. We have had virtually no trade policy of any great significance, at least for 6 or 7 years. We finally passed a trade bill. But—I mean, I do not follow the logic of suggesting we ought not be concerned about degree of subsidized wine alcohol. I guess we disagree on that?

Mr. DURBIN. Would the gentleman allow me to respond?

Mr. DORGAN. Sure.

Mr. DURBIN. If I might, to try very quickly, in the context of 1986 there was great uncertainty about the future. We were having battles every several months over the additions of various compounds to the ethanol which was being exported to the United States. There was uncertainty in the industry as to what the political action would be once Congress came to realize that the European wine was the major feed stock that was going to be used.

It was very clear that we were subsidizing this export to the United States at great expense to the Federal Treasury, that great profits were being made, and the companies were recouping their capital in a matter of months, and, as Mr. Dorgan has indicated, that there would be no full fermentation facilities built so long as we allowed this to continue.

In that climate the companies came forward and decided to sue for peace, let us bring this to a conclusion. And they said to us, if you will allow us to continue to reap these profits from European wine for several years, we will give you what you are seeking, the full fermentation facility. We found very quickly that they reneged on that promise.

Mr. DORGAN. Mr. Chairman, let me make one other statement.

Because we have over 80 cities that are in noncompliance with the air pollution standards, I think we are headed for a future very

much like ARCO is providing in Phoenix, and probably other cities as well soon, that is providing ethanol additives to gasoline to clean the air. And when that is required, either by economics or by law, or for whatever reason, I think we are going to see a much greater market, expanded market for ethanol.

I am not interested in protecting the domestic industry. We have an ethanol plant—two ethanol plants in North Dakota. It is not my intention to worry about protecting their markets from full fermentation plants producing ethanol in the Caribbean. As far as I am concerned, they are welcome to compete in this country. But I am concerned about jobs in the Caribbean.

I have been in Haiti, I have been in a good many of the Central American countries. And frankly, it is a shame to see those cane fields down and all the unemployment and nothing going on. It would be great if we could have some ethanol plants that are full fermentation creating jobs down there and see those cane fields growing cane and have the product use full fermentation plants.

Chairman GIBBONS. All right. Well, we have a lot of witnesses today. And we may be here until midnight if we do not move on.

Thank you all very much.

Next we have the U.S. General Accounting Office, Mr. Mendelowitz; and we have the International Trade Commission, Vern Simpson, and company.

Mr. Mendelowitz, we will hear from you first.

STATEMENT OF ALLAN I. MENDELOWITZ, DIRECTOR, TRADE, ENERGY AND FINANCE ISSUES, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY WAYNE FARRISH, PROJECT MANAGER, AND BARBARA KELLER-COHEN, SENIOR EVALUATOR

Mr. MENDELOWITZ. Thank you, Mr. Chairman.

Before I begin, I would like to introduce my colleagues who are with me today.

Chairman GIBBONS. Certainly.

Mr. MENDELOWITZ. On my immediate left is Wayne Farrish, who is the project manager on the assignment we did, pursuant to the Trade Act, on ethanol imports from the Caribbean. And next to him is Barbara Keller-Cohen, who is a senior evaluator on the assignment.

I have to say that after listening to the debate of the first panel, I can tell I am going to earn my salary today.

I am happy to be here today to discuss with you our review of fuel ethanol imports from Caribbean Basin Initiative countries, which was made in response to the requirement of the 1988 Omnibus Trade Act. We issued the report as required by the legislation on February 21, 1989.

I will make a few comments now referring to that report and of course submit my full statement for the record.

The 1983 Caribbean Basin Initiative Recovery Act permits eligible products from designated countries and U.S. insular possessions to be imported into the United States duty free if at least 35-percent of their value was added in these countries.

Subsequent to the 1983 CBI legislation several companies built dehydration facilities in CBI countries to produce ethanol for export to the United States. Rather than make the product by a process of full fermentation of local feed stocks, such as sugar cane, the companies imported dehydrated, low-cost European wine alcohol. This activity has been described as a pass-through operation. Local processing costs accounted for most of the value-added requirement. And the companies did add local feed stock as necessary to meet the 35 percent requirement.

The U.S. ethanol industry objected to the pass-through operations because they believe the heavily subsidized European wine alcohol gave the Caribbean ethanol producers an unfair cost advantage in the U.S. markets, and that the distillation process did not meet the requirement of substantial transformation under the Caribbean Basin Economic Recovery Act [CBERA].

To discourage pass-through operations, the Tax Reform Act of 1986 provided that ethanol qualified for duty-free entry only if raw materials, that is the feed stock, from the region accounted for at least 30 percent of the value added in 1987, 60 percent in 1988 and 75 percent in 1989 and thereafter. The act provided a limited exemption for several facilities already completed or under construction.

The Trade Act required GAO to study whether the 75 percent local feed stock requirement would contribute to the economic development of the CBI countries by making maximum use of their natural resources.

The act specified the study should assess whether the local feed stock requirement is economically feasible for ethanol producers and, if not, to recommend modifications to the requirement that, one, will ensure meaningful production and employment in the region; two, discourage the processing of feed stock obtained outside the region; and three, not result in harm to ethanol producers in the United States. The act also required GAO to assess the effects of CBI ethanol imports on U.S. producers.

In summary, our review showed that given current sugar and gasoline prices, it is not economically feasible for CBI ethanol producers to meet the 75-percent local feedstock requirement. At current prices, CBI countries can be competitive with no more than a 10 to 30 percent local feedstock requirement. Therefore, the 75-percent requirement will not permit CBI producers to be competitive and will not contribute to the economic development of CBI countries.

To date, ethanol imports from CBI countries have been small and have had little impact on the U.S. market. However, eliminating the requirement for local feed stock would give CBI ethanol producers an advantage in the U.S. market if they can readily obtain subsidized European wine alcohol supplies at low prices.

However, because it is questionable that the CBI producers can secure large quantities of subsidized wine alcohol, they are not likely to have a large share of the U.S. market.

The policy objectives of the 1988 legislation, that the local feedstock will increase meaningful production and employment in the region, discourage passthrough operations, and not harm the U.S.

ethanol producers, are in conflict and cannot all be realized at the same time.

Referring briefly to the impact of the ethanol imports on the U.S. market, between 1979 and 1985, U.S. ethanol sales grew rapidly. Since then, however, they have stagnated, and annual sales are currently about 850 million gallons. Past imports from CBI countries peaked at about 29 million gallons or 3 percent of the U.S. market in 1987.

Questionnaire responses from several ethanol producers to the International Trade Commission in the fall of 1988 indicated little impact to date from CBI imports. Only a few examples of price depression or lost sales over the last several years were provided.

The future impact of CBI ethanol imports will depend importantly on U.S. restrictions, CBI production capacity, availability of low-cost European wine alcohol feed stock, and the growth of the U.S. market. The strength of the market depends on the continued availability of government subsidies. Basically, at current price levels, if the subsidies for alcohol for fuel were dropped after 1992 and 1993 when they are due to expire, you would not have a fuel alcohol business. And any future unsubsidized use depends on future corn and oil prices and expanded use of ethanol to enhance gasoline octane ratings and reduce pollution.

Because our report pointed out that the objectives of the legislation were in conflict, we presented three options to show a possible range of alternatives available, depending on the priorities of the Congress.

In the first option, in addition to the 35-percent value added requirement, Congress could set a local feedstock requirement ranging from 10 to 25 percent. Currently most companies could probably meet a 10-percent requirement and some might meet a higher one. Under the assumption that all prices will continue to increase in future years, Congress could initially require that companies meet a 10 percent requirement with increases 20 to 30 percent in future years.

If the price structure improves, the companies might be able to meet a higher requirement. However, if the cost or price structure becomes less favorable in the future, it would make companies noncompetitive.

Option two would eliminate any local feedstock requirement while maintaining the 35 percent value-added requirement of the original Caribbean Basin Initiative Law. One reason for considering this option is that the local feedstock requirement for ethanol changed the rules for a CBI product after investments had already been made. CBI government officials believe this change has adversely affected investor interest in the CBI program more generally.

Option two would enable all currently exempt plants to operate as long as they can meet the original 35-percent value-added standard. Plants have used some local feedstock to meet this requirement and some plan to maximize the use of local feedstock as long as their ethanol is still competitive. However, option two would not encourage companies to maximize the use of local feedstock.

Option three stems from the 1988 Trade Act provision. The act provided a limited exemption from the local feedstock require-

ments for 1988 and 1989 for a number of CBI dehydration facilities already completed or under construction. Each can import into the United States up to 20 million gallons of ethanol duty-free without meeting the 75 percent feedstock requirement.

Option three would provide permanent exemptions from any local feedstock requirement up to a 20-million-gallon-a-year cap for each of the currently exempt plants. A local feedstock requirement, say 30 percent or higher, could be established for exports above the cap or for all production of any new plants.

This option would enable exempted plants to operate as long as they meet the 35-percent value-added requirement of CBI, but also provide an incentive to use additional local feedstock to increase exports above the cap. It would cap CBI exports based on low-cost imported feedstock at a maximum of 120 million gallons per year and insure U.S. industry that exports over that amount would include at least 30 percent local feedstock.

Mr. Chairman, this concludes my summary comments. And we'll be happy to try to answer questions you may have.

[The statement of Mr. Mendelowitz follows:]

United States General Accounting Office

GAO Testimony

For Release on
Delivery Expected
at 1:00 p.m. EDT
Tuesday
April 25, 1989

FUEL ETHANOL: Imports from Caribbean Basin Initiative Countries

Statement of
Allan I. Mendelowitz, Director
Trade, Energy, and Finance Issues
National Security and International
Affairs Division

Before the
Subcommittee on Trade
Committee on Ways and Means
House of Representatives

Mr. Chairman and Members of the Subcommittee:

I am happy to be here today to discuss with you our review of fuel ethanol imports from Caribbean Basin Initiative countries which was made in response to a requirement in the Omnibus Trade and Competitiveness Act of 1988. We issued a report on February 21, 1989,[1] and today I will highlight the major results of our review.

BACKGROUND

The 1983 Caribbean Basin Economic Recovery Act (CBERA) permits eligible products from designated countries and U.S. insular possessions in Central America and the Caribbean (referred to as CBI countries) to be imported into the United States duty free if at least 35 percent of their value was added in these countries.

Subsequent to the 1983 CBI legislation, several companies built dehydration facilities in CBI countries to produce ethanol for export to the United States. Rather than make the product by a process of full fermentation of local feedstock, such as sugarcane, the companies imported and dehydrated low-cost, European wine alcohol. This activity has been described as a pass-through operation. Local processing costs accounted for most of the value-added requirement and the companies added local feedstock, as necessary, to meet the 35-percent requirement.

The U.S. ethanol industry objected to pass-through operations because it believed the heavily subsidized European wine alcohol gave the Caribbean ethanol producers an unfair cost advantage in U.S. markets and that the distillation process did not meet the requirement for substantial transformation under the CBERA.

To discourage pass-through operations, the Tax Reform Act of 1986 provided that ethanol qualified for duty-free entry only if raw materials (feedstock) from the region accounted for at least 30 percent of the value of the ethanol when it entered the United States in 1987, 60 percent in 1988, and 75 percent in 1989 and thereafter. The Act provided a limited exemption for several facilities already completed or under construction.

The Omnibus Trade and Competitiveness Act of 1988 required GAO to study whether the 75-percent local feedstock requirement would contribute to the economic development of the CBI countries by making maximum use of their natural resources. The Act specified that the study should assess whether the local feedstock requirement is economically feasible for ethanol producers, and if not, to recommend modifications to the requirement that (1) will insure meaningful production and employment in the region, (2) discourage the processing of feedstock obtained outside the region, and (3) not result in harm to ethanol producers in the United States. The Act also required GAO to assess the effects of CBI ethanol imports on U.S. producers.

RESULTS IN BRIEF

In summary, our review showed that given current sugar and gasoline prices, it is not economically feasible for CBI ethanol producers to meet the 75-percent local feedstock requirement. At current prices, CBI companies can be competitive with no more than a 10- to 30-percent local feedstock requirement.[2] Therefore, the 75-percent requirement will not permit CBI producers to be competitive and will not contribute to the economic development of CBI countries.

---

[1]Fuel Ethanol: Imports From Caribbean Basin Initiative Countries (GAO/NSIAD-89-106).

[2]Companies which were required by the Tax Reform Act to meet a 60-percent local feedstock requirement in 1988 did not export ethanol to the United States.

To date, ethanol imports from CBI countries have been small and have had little impact on the U.S. market. However, eliminating the requirement for local feedstock would give CBI ethanol producers an advantage in the U.S. market if they can readily obtain subsidized European wine alcohol supplies at low prices.

The policy objectives of the 1988 legislation--i.e., that the local feedstock requirement will (1) increase meaningful production and employment in the region, (2) discourage pass-through operations, and (3) not harm U.S. ethanol producers--are thus in conflict and involve tradeoffs.

STATUS OF THE CBI ETHANOL INDUSTRY

The Caribbean area has two kinds of fuel ethanol production: (1) full fermentation and (2) dehydration. The former includes a fermentation, distillation, and dehydration facility. The ethanol is produced from either sugarcane juice or molasses. The primary factor affecting the cost of full fermentation ethanol is the cost of the feedstock.

Currently, Costa Rica, El Salvador, and Guatemala have full fermentation facilities. Their combined design capacity is 41 million gallons a year (MGY); however, the most that any of these countries ever shipped to the United States was 4.6 million gallons in 1985. Since February 1988, none of these countries has shipped any fuel ethanol to the United States.

CBI dehydration plants produce dry ethanol from wet ethanol[3] through an azeotropic distillation process. Wet ethanol containing less than 95 percent alcohol must be rectified or distilled before dehydration or run through the dehydration system twice to reach the dry level.

Since 1984, four companies have built dehydration plants in the CBI region and have operated and exported ethanol to the United States. These include Tropicana and Petrojam in Jamaica, LAICA in Costa Rica, and U.S. Resources, now owned by VIAG, in the U.S. Virgin Islands. We estimate their current effective combined production capacity at about 88 MGY. Two other plants are under construction but may never be completed. These are Allied Ethanol on Grand Bahama Island and BioCom in the U.S. Virgin Islands. If they are finished and certain improvements are made to all plants, maximum ethanol production capacity of these six plants might reach 212 million gallons a year.

Feasibility of local feedstock requirements

To assess the economic feasibility of the local feedstock requirement, we estimated what it would cost CBI companies to produce ethanol and deliver it to the United States based on a mixture of CBI wet ethanol (enough to meet the 75-percent local feedstock requirement) and European wine alcohol. We then compared the estimated cost to the market price of ethanol in the United States. We focused on European wine alcohol for the non-CBI feedstock because that is what CBI companies have largely used and because these stocks are the source of concern to U.S. ethanol producers. We also analyzed CBI costs under alternative local feedstock requirements and various CBI feedstock costs.

Table 1 shows the results of simulated CBI ethanol costs under alternative local feedstock requirements, ranging from 10 to 75 percent. In addition, we simulated how alternative world sugar

---

[3]To be suitable for blending with gasoline, ethanol must be virtually anhydrous (i.e., the water content cannot exceed 0.5 %). We refer to this as fuel or dry ethanol.

prices (5 to 15 cents a pound) could affect CBI feedstock costs and, in turn, overall production costs.

As table 1 shows, with a 75-percent local feedstock requirement and based on the recent cost structure, including a sugar price of 9 to 10 cents a pound, it would cost about $1.30 to $1.41 a gallon to make the ethanol and ship it to the United States. The average annual price of ethanol in the United States during 1987 and 1988 was $1.06 to $1.08 a gallon. At that price, the 75-percent local feedstock requirement would result in costs well above the price at which the ethanol could be sold.

Under the current cost structure and a 30-percent feedstock requirement, it would cost CBI companies about $1.03 to $1.17 a gallon to produce and ship fuel ethanol to the U.S. east coast. Thus, based on these prices, some companies would be competitive and others would not. If sugar prices increase to 15 cents a pound (corresponding to $1.80 to $2.10 a gallon CBI wet ethanol cost), the situation would worsen for the CBI firms. If sugar prices decline to about 5 cents a pound (60 to 70 cents a gallon wet ethanol cost), CBI companies could compete using only CBI feedstock. However, a recent World Bank study projected that world sugar prices are likely to increase by about a few cents a pound over the next several years.

With a CBI feedstock requirement ranging between 10 and 25 percent and under the current cost structure, it would cost from 91 cents to $1.14 a gallon to make the ethanol and ship it to the United States. If sugar increases to 15 cents a pound, company costs would range from 93 cents to $1.18 a gallon. If sugar prices drop to 5 cents a pound, all the companies that fall within the representative cost structure could compete.

Table 1: Simulated CBI Ethanol Production Costs Under Alternative Feedstock Requirements[a]

CBI feedstock Percentage[c]	Cost of CBI Wet Ethanol[b] $.60-.70[d]	$1.20-1.40 (current cost)	$1.80-2.10
10	.86 - 1.00	.91 - 1.06	.93 - 1.07
15	.86 - 1.00	.94 - 1.08	.96 - 1.11
20	.87 - 1.00	.97 - 1.11	1.00 - 1.15
25	.87 - 1.00	1.00 - 1.14	1.04 - 1.18
30	.88 - 1.00	1.03 - 1.17	1.08 - 1.22
60	(e) - 1.00	1.21 - 1.33	1.31 - 1.44
75	(e) - (e)	1.30 - 1.41	1.42 - 1.55

[a]Includes shipping to the east coast and customs charges. We assume CBI feedstock is mixed with European feedstock priced at 55 to 70 cents a gallon (190 proof) and processing and shipping costs are 30 cents a gallon.

[b]The recent world free-market sugar price was about 9 to 10 cents a pound. Assuming a proportional relation between this sugar price and CBI wet ethanol cost, the lower cost wet ethanol should be available when the sugar price is about 5 cents a pound and the higher cost wet ethanol should be available when the sugar price is about 15 cents a pound.

[c]Consistent with the Tax Reform Act, the simulation assumes the feedstock requirement is based on the value of the local feedstock relative to the value of the product. In estimating the required volume of CBI feedstock, an ethanol value of $1.10 a gallon was assumed.

[d]When CBI and European wet ethanol both sell for 70 cents a gallon, production costs do not vary.

[e]In these cases, it is cheaper for a company to use 100 percent CBI feedstock, which also qualifies for duty-free entry into the United States.

Production and employment from fuel ethanol in the Caribbean

According to one estimate, a 20-MGY dehydration facility should have a work force of up to 20 to 25 employees. On the other hand, a 20-MGY full fermentation plant annexed to a sugar mill would use enough sugarcane to employ 980 full-time and seasonal workers and 30 employees who operate the fermentation distillation plant.

One company in Costa Rica and one in Jamaica which operate dehydration-only facilities have also invested in sugarcane and full fermentation facilities. Another company in Jamaica has invested in sugar production and could build a full fermentation facility if the economics warrant it. However, the existing facilities can supply only a limited amount of the total feedstock required to operate the dehydration facilities. These facilities are seen as a way for the host countries to decrease their dependence on the sugar market by diversifying their use of sugarcane. Host-country governments believe this to be important, especially in light of declining U.S. sugar import quotas. CBI countries have been seriously affected by substantial reductions in their allocations under the U.S. sugar quota system which, in aggregate, declined 83 percent between 1981 and 1986. Ethanol is seen as a way of maintaining existing employment in the sugar

industries of these countries. The U.S. Virgin Islands sees it as a way of reducing dependence on the tourist industry.

New investment in sugar and full fermentation facilities is unlikely without greater assurance of a long-run rate of return and a more favorable price structure than currently exists.

Although dehydration of imported wine alcohol provides significantly less employment and local production than full fermentation of local feedstock, it does provide CBI countries with economic benefits through employment and foreign exchange. The companies and government officials informed us that

-- all dehydration plants are capital investments in CBI countries;

-- the companies pay for local goods and services, most pay taxes on local purchases, and all pay salaries to host-country employees;

-- the dehydration plants directly employ about 25 to 40 persons, many of whom are college-educated, as well as maintenance, security, seaport, and other contract personnel; and

-- the companies provide revenue for the local port authorities.

STATUS OF THE U.S. ETHANOL INDUSTRY

To decrease U.S. dependence on imported oil, federal and state tax incentives have been provided since 1978 that made gasoline-ethanol blends, known as gasohol, competitive with gasoline. The federal gasoline tax exemption and the blender's tax credit, an alternative to the tax exemption, currently are 6 cents a gallon for gasohol and 60 cents a gallon for ethanol. These incentives are scheduled to expire September 30, 1993 and December 31, 1992, respectively. At existing gasoline prices, ethanol is not competitive without the federal subsidy.

Early on, Congress decided against subsidizing ethanol imported from another nation. In 1980 it instituted tariffs on imports of foreign ethanol to offset the federal subsidy which ethanol enjoys. The tariff began lower but has been equal to the federal subsidy for domestic ethanol since 1982. Qualifying imports from CBI countries are exempt from this tariff and thus fully benefit from the federal ethanol subsidy.

Total U.S. fuel ethanol production capacity is estimated at 1.36 billion gallons a year, almost 74 percent of which is concentrated in the Midwest. Current operating capacity is about one billion gallons. One large Midwestern producer accounts for over 66 percent of the operational capacity and three smaller Midwestern producers account for almost 20 percent. As of the fourth quarter of 1987, there were 61 operating companies and a total of 77 companies had been shut down.[4]

Some states provide excise tax exemptions, sales tax exemptions, or producer tax credits for ethanol, ranging in value from 10 cents to $1.40 per gallon of ethanol. Certain states impose restrictions on the applicability of ethanol incentives, such as "in-state" or "home-grown" clauses that are intended to encourage local production.

There is a strong correlation between the availability and generosity of state subsidies and fuel ethanol production and market penetration. CBI ethanol is not eligible for tax incentives in most states. This gives domestic producers an important advantage. However, during the past few years a number of states

---

[4]Source: Information Resources, Inc., Washington, D.C.

have reduced or eliminated their subsidies and more are expected to do so in the next few years. In January 1987, 28 states provided tax incentives whereas in January 1989 only 23 states did so.

Impact of CBI ethanol imports

Between 1979 and 1985, U.S. ethanol sales grew rapidly. Since then, however, they have stagnated. Annual sales are currently about 850 million gallons. Past imports from CBI countries peaked at about 29 million gallons, or 3 percent of the U.S. market in 1987. Questionnaire responses from several ethanol producers to the International Trade Commission in the fall of 1988 indicated little impact to date from CBI imports. Only a few examples of price suppression or lost sales over the past several years were provided.

The future impact of CBI ethanol imports will depend importantly on U.S. restrictions, CBI production capacity, availability of low-cost European alcohol feedstock, and growth of the U.S. market. The strength of the market depends on the continued availability of government subsidies, future corn and oil prices, and expanded use of ethanol to enhance gasoline octane ratings and reduce pollution.

SURPLUS EUROPEAN WINE ALCOHOL

In December 1988, the European Community (EC) approved a proposal for disposing of surplus alcohol stocks. The EC Commission advised us that the stocks on hand equaled about 264 million gallons of alcohol at the end of 1988. The Commission has estimated that another 291 million gallons of wine alcohol will be acquired during 1989-92. The Commission plans to sell a sizeable portion of these stocks in 1989 and additional stocks that it acquires over the next several years. It is estimated that by the end of 1992 the only surplus stocks would be those purchased that year (estimated at 58 million gallons).

It is questionable whether Caribbean producers can currently secure sufficient quantities of surplus European alcohol stocks to supply 88 to 120 MGY of capacity. Most CBI companies told us that it is difficult to purchase European wine alcohol stocks of adequate quality and at prices which would allow them to produce fuel ethanol at a price competitive in the U.S. market. If the EC succeeds in its objective of substantially reducing the structural surplus in wine production over the next several years, CBI producers may no longer be able to secure low-cost European wine alcohol.

POLICY OPTIONS

Setting or modifying a local feedstock requirement tailored to today's market conditions is difficult because its impact can vary significantly as sugar, corn, and/or oil prices change. Prices for these commodities have varied substantially in the past. In addition, individual company cost structures differ. The risk involved in setting a specific requirement is that, at any given time, it may either be so low as to promote pass-through operations or so high as to make CBI companies uncompetitive.

An added difficulty in modifying the 75-percent local feedstock requirement as contemplated by the 1988 Trade Act is that the several policy objectives of that legislation are in conflict. Thus, our report discusses three options which were presented to show a possible range of options available, depending on the priorities of the Congress.

In the first option, in addition to the 35-percent, value-added requirement, Congress could set a local feedstock requirement ranging between 10 to 25 percent. Currently, most companies could probably meet a 10-percent requirement and some might meet a higher one. Under the assumption that oil prices will increase in

future years, Congress could initially require that companies meet a 10-percent requirement, with increases to 20 or 30 percent in future years. If the price structure improves, the companies might be able to meet a higher requirement; however, if the cost or price structure becomes less favorable in the future, it could make companies noncompetitive.

Option two would eliminate any local feedstock requirement while maintaining the 35-percent, value-added requirement of the original CBI law. One reason for considering this option is that the local feedstock requirement for ethanol changed the rules for a CBI product after investments had already been made. CBI government officials believe this change has adversely affected investor interest in the CBI program more generally. Option two would enable all currently exempt plants to operate as long as they can meet the original 35-percent, value-added standard. Plants have used some local feedstock to meet this requirement and some plan to maximize the use of local feedstock as long as their ethanol is still competitive. However, option two would not encourage companies to maximize the use of local feedstock.

Option three stems from the 1988 Trade Act provision. The Act provided a limited exemption from the local feedstock requirements for 1988 and 1989 for a number of CBI dehydration facilities already completed or under construction. Each can import into the United States up to 20 million gallons of ethanol duty free without meeting the 75-percent local feedstock requirement. Option three would provide permanent exemptions from any local feedstock requirement, up to a 20-MGY cap, for each of the currently exempt plants. A local feedstock requirement, say 30 percent or higher, could be established for exports above the cap or for all production of any new plants. This option would enable the exempted plants to operate as long as they meet the 35-percent, value-added requirement. It would also provide an incentive to use additional local feedstock to increase exports above the cap. It would cap CBI exports based on low-cost, imported feedstock at a maximum of 120 MGY and ensure U.S. industry that exports over that amount would include at least 30 percent local feedstock.

Mr. Chairman, this concludes my prepared statement. I will be happy to respond to any questions you may have.

Chairman GIBBONS. Thank you, Mr. Mendelowitz.

We will go now to Mr. Stewart, and then we will come back—Mr. Simpson, excuse me. And then we will come back to both of you.

Mr. Simpson, we welcome you.

STATEMENT OF VERN SIMPSON, ACTING DIRECTOR, OFFICE OF INDUSTRIES, U.S. INTERNATIONAL TRADE COMMISSION, ACCOMPANIED BY EDMUND CAPPUCCILLI, CHIEF, ENERGY, PETROLEUM, BENZENOID CHEMICALS, AND RUBBER AND PLASTICS BRANCH, AND JOSEPH FRANCOIS, TRADE ECONOMIST

Mr. SIMPSON. Thank you, sir.

Mr. Chairman, members of the subcommittee, we are pleased to be here today to present the results of the Commission's recent study on the ethanol market.

Seated beside me are the two principal authors of the study, Mr. Ed Cappuccilli, a senior energy and industry analyst, and Mr. Joe Francois, a Commission trade economist.

In its investigation, the Commission did not attempt to recommend a specific alternative to the existing indigenous feedstock requirements for CBI countries. Rather, the Commission attempted to present for policymakers the likely effects of alternative feedstock requirements on CBI production costs, and ultimately on the level of U.S. imports. Further, the Commission attempted to demonstrate the difficulty of setting a feedstock requirement that will meet the dual objectives of both promoting a viable CBI industry while at the same time avoiding harm to a U.S. industry. The difficulty arises because of the continuing shifts in external market factors which can significantly change the viability of CBI producers. These factors include gasoline prices, U.S. corn prices, world and U.S. sugar prices, and the availability and price of imported feedstock for CBI producers.

Briefly, the Commission's principal study findings are as follows:

One, because sugarcane and molasses are the major CBI indigenous feedstocks, developments in sugar and molasses markets affect CBI producer production costs. Thus the feasibility of CBI ethanol production from indigenous materials is strongly influenced by the sugar policies of major consuming nations such as the United States, their own domestic sugar needs, and the world prices of sugar and molasses.

Two, imported feedstocks principally from the European Community in the form of wine based hydrous ethanol have enhanced the competitiveness of CBI producers by lowering their overall feedstock costs. During 1988, for example, imported feedstocks had an average cost of 63 cents per gallon compared to a cost of $1.20 per gallon for indigenous feedstock.

During 1985 through 1988, approximately 68 percent of U.S. imports of ethanol from CBI nations were produced from European wine alcohol. Despite this level of use of EC wine, U.S. ethanol imports from CBI countries at no time accounted for more than 4 percent of total U.S. consumption.

Point three, indigenous feedstock requirements have a significant effect on the cost of production of CBI ethanol producers. The 30 percent feedstock requirement in effect in 1987 is estimated to

have resulted in a per gallon cost of production approximately 12 percent higher than would have resulted with just the normal 35 percent value-added requirement. In the same year raising the feedstock requirement to 75 percent would have increased CBI production costs by yet another 26 percent.

Four, in 1987 the peak year for U.S. imports of CBI ethanol, the CBI countries exported 29 million gallons of ethanol, had 11 plants in operation or planned, and employed an excess of 6,000 workers in the ethanol industry including seasonal cane field workers.

Under 1988 market conditions, a CBI——

Chairman GIBBONS. That is 11,000?

Mr. SIMPSON. 6,000.

Chairman GIBBONS. 6,000 workers.

Go ahead.

Mr. SIMPSON. Under 1988 market conditions a CBI ethanol industry of comparable size would only have been feasible under a feedstock requirement of 35 percent or less. Based on 1987 market conditions, the Commission estimated that full implementation of the 75-percent requirement with its accompanying increase in CBI production costs would result in a lowering of CBI exports by one-third or more with attendant costs to CBI economies and increased ethanol costs to U.S. consumers. There would not be a significant effect on CBI employment going to a 75-percent requirement, but rather a reallocation of cane workers from producing cane for sugar to producing cane for ethanol.

Because the number of CBI producers is limited, the reduction in CBI exports would mean producers might operate only infrequently or on very sporadic schedules.

Seven, a single indigenous feedstock requirement cannot compensate for all of the variations that occur in this complex market. Thus a fixed content requirement cannot guarantee any given level of CBI industry viability or a stable level of U.S. imports.

In closing, whatever the final policy decision regarding indigenous feedstock requirements, other import relief trade laws which the Commission helps administer should continue to act as a safeguard in the event of unforeseen market conditions.

We will be pleased to answer any questions you might have.

[The statement of Mr. Simpson follows:]

STATEMENT OF VERN SIMPSON, ACTING DIRECTOR OF THE OFFICE OF INDUSTRIES
UNITED STATES INTERNATIONAL TRADE COMMISSION
BEFORE THE SUBCOMMITTEE ON TRADE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
APRIL 25, 1989

FUEL ETHANOL IMPORTS FROM CARIBBEAN BASIN INITIATIVE COUNTRIES

Mr. Chairman and members of the Subcommittee, I am pleased to be here today to present the results of the U.S. International Trade Commission's report on fuel ethanol, prepared in accordance with the reporting requirement contained in The Omnibus Trade and Competitiveness Act of 1988. My name is Vern Simpson and I am currently the Acting Director of the Commission's Office of Industries. Seated beside me are the principal authors of the Commission's report, Mr. Ed Cappuccilli, a senior energy and chemical analyst, and Mr. Joe Francois, a Commission trade economist.

In its investigation of the ethanol market, the Commission did not recommend a specific alternative to the existing indigenous feedstock requirements for CBI countries. Rather the Commission attempted to present for policy-makers the likely effects of alternative feedstock requirements on CBI production costs and ultimately on the level of U.S. imports from the CBI countries. Further, the Commission attempted to demonstrate the difficulty of setting an indigenous feedstock requirement that will meet the dual objectives of promoting a viable CBI industry and avoiding harm to a U.S. industry. The difficulty arises principally because of the continuing shifts in external market factors which can result in significant changes in the viability of CBI country producers and in CBI export levels to the United States. These factors include gasoline prices, U.S. corn prices, world and U.S. sugar prices, and the availability and price of foreign feedstock for CBI producers.

In attempting to evaluate the feasibility of indigenous content requirements and their effects on Caribbean and U.S. ethanol producers, the Commission examined all aspects of the fuel ethanol market. The Commission's principal observations in these areas are highlighted below.

The Caribbean Basin fuel ethanol industry

- o The economic feasibility of Caribbean Basin fuel ethanol production from indigenous materials is strongly influenced by the trade policies of major sugar-consuming nations, domestic sugar needs, and the world prices of sugar and molasses.

Sugarcane is the major indigenous feedstock used in the production of Caribbean Basin fuel ethanol. Currently, the preferred end use for sugarcane, at any particular time, is determined by preferential trading arrangements, domestic use, and the world price of sugar. Increases in the price of sugar will usually increase the price of indigenous fuel ethanol feedstock.

For practical purposes, molasses would most likely be the indigenous feedstock for an ethanol producer not directly associated with a sugar mill. Although molasses is a byproduct of sugar manufacture, its price is determined by the supply and demand in the markets for animal feed and rum.

Since the production of large quantities of CBERA fuel ethanol from indigenous feedstock would require purchasing molasses at world prices or acquiring sugarcane that could be processed into ethanol at prices competitive with the price of sugar, developments in the sugar and molasses markets strongly affect the price of indigenous feedstock (Chapter 2 of Commission report).

- o Although the Caribbean Basin nations are major producers of sugarcane, the policies of other countries tend to limit production of this primary ethanol feedstock.

The sugar industry is the largest employer and sugar is the primary export commodity for the sugar-producing nations eligible for duty-free entry of sugar into the United States under the provisions of the CBERA. However, all of these nations faced declining U.S. sugar quota allocations, as the total quota was reduced in every year between 1983, when the CBERA was enacted, and July 1988, when the overall quota was increased to just over the 1987 level. The primary use of sugarcane is sugar, while ethanol production utilized a relatively small amount of sugarcane--less than 5 percent. As these nations lost sugar sales to the United States, their primary export market, most began to diversify away from sugarcane and toward the production and exportation of other crops (Chapter 2 of the Commission report).

- Imported feedstocks, principally from the European Community in the form of wine-based, partially distilled hydrous ethanol, have enhanced the competitiveness of Caribbean Basin producers by lowering overall feedstock cost.

In 1982, the European Commission provided for distillation of excess wine production in the member nations to assist the European wine industry. Since that time, a significant stock of partially distilled hydrous ethanol from the excess wine stocks has accumulated. This wine alcohol has been available for use as an inexpensive feedstock for the Caribbean producers of fuel ethanol to use in their azeotropic distillation facilities. Once it has been processed by the Caribbean Basin producers, this product could enter the United States under the CBERA exempt from the $0.60 per gallon tax placed on imports of the wine-based alcohol. The exemption, however, is allowed only if this product is blended with fuel ethanol produced from CBERA feedstock to meet the indigenous feedstock requirements (Chapter 3 of the Commission report).

- U.S. imports of fuel ethanol from CBI nations from 1985 through September 1988 amounted to just over 93 million gallons. Approximately 63 million gallons of these imports were produced from surplus European wine alcohol.

U.S. imports of fuel ethanol from CBI nations have been produced from surplus European wine alcohol, sugarcane juice, and molasses. Caribbean Basin fuel ethanol producers purchased approximately 80 million gallons of surplus wine alcohol from various European nations' surplus stocks or from various private European distilleries during 1985-88. These purchases were dehydrated to produce approximately 63 million gallons of fuel ethanol, which accounted for 68 percent of U.S. imports of this product from CBI nations during this period. Despite the significant use of surplus European wine alcohol during this period, the volume of fuel ethanol imports from CBI countries at no time accounted for more than 4 percent of total U.S. consumption (Chapter 3 of the Commission report).

The U.S. fuel ethanol industry and market

- The potential for ethanol's expanded use in the U.S. market as an octane enhancer has been inhibited to date by both technical difficulties and cost competitiveness problems.

Although ethanol has an octane rating about 7 percent higher than methyl tert-butyl ether (MTBE), an octane enhancer, and produces lower levels of carbon monoxide than gasoline when combusted, there are problems associated with its use. For example, ethanol's volatility presents environmental concerns and its water-absorbing qualities result in additional costs and limitations in storage and distribution.

Unlike the cost of other octane enhancers, the cost of U.S. ethanol production is dependent on the price of corn. Without existing Federal assistance to the ethanol industry, and with corn prices at $2 per bushel, crude petroleum prices would have to be at least $40 per barrel for ethanol to be a cost-competitive octane enhancer (Chapter 4 of the Commission report).

- Demand for fuel ethanol, which lowers carbon monoxide emissions from combustion, may increase as efforts are made to attain air quality targets specified in the Clean Air Act.

The attractiveness of fuel ethanol as a gasoline extender has declined in an era of lower gasoline prices. Absent higher gasoline prices or lower net corn costs, increased demand for fuel ethanol currently hinges on its role as a fuel oxygenator, which can reduce emissions of carbon monoxide (Chapter 4 of the Commission report).

- In 1987, shipments of U.S.-produced fuel ethanol were mainly to the Midwestern States or States granting subsidies, while imports were shipped to the Gulf and Eastern Coast States. Also, prices of Caribbean and U.S.-produced fuel ethanol during 1985-87 often differed significantly in the same quarter.

Responses to the Commission questionnaire showed that nearly 60 percent of reported shipments of U.S.-produced fuel ethanol were to Illinois, Ohio, Indiana, Michigan, and Iowa. Fuel ethanol was also shipped to 21 other States including Texas, California, Virginia, Louisiana, and Maryland. Based on Commission questionnaire responses, transportation costs from a Midwestern plant to these Coastal States ranged from 9 to 14 percent of the delivered price. In 1987, imports of CBERA fuel ethanol were shipped mainly to Louisiana, Virginia, and Maryland. During 1985-88, the prices of CBERA and U.S-produced fuel ethanol varied from each other and frequently moved in opposite directions in the same quarter (Chapter 4 of the Commission report).

Indigenous feedstock requirements for Caribbean producers

- Indigenous feedstock requirements have a significant effect on the cost of production of CBI ethanol producers.

The 30-percent indigenous feedstock requirement in effect in 1987 is estimated to have resulted in a per gallon cost of production 12 percent higher than would have resulted with only a 35-percent value-added requirement under the CBERA. In that same year, an indigenous feedstock requirement of 75 percent would have increased costs by an additional 26 percent over that with the 30-percent indigenous requirement (Chapter 5 of the Commission report).

- The level of U.S. imports from the Caribbean Basin fuel ethanol producers depends not only on the indigenous feedstock requirement and its feedstock costs, but significantly on gasoline prices and U.S. net-corn prices.

The net cost of corn for U.S. fuel ethanol producers affects their cost of production. For example, the increase in U.S. net-corn prices since 1987 has led to an approximate increase in U.S. producers' average variable cost of production from $0.61 to $0.92 per gallon of ethanol. Based on a model of the ethanol market developed by the Commission, this increase in U.S. producer's costs alone, all other factors held constant,

would have resulted in an increase of U.S. imports from CBI-eligible countries of over 14.5 million gallons per year. Of course, if U.S. corn prices fall, the CBI countries would become less competitive in the U.S. market and their exports would decline.

As the price of gasoline falls, ethanol becomes less attractive as a gasoline extender and octane enhancer, and hence demand for ethanol declines. For example, a decline in the prices of gasoline from $0.97 to $0.92 per gallon, as happened between the last quarter of 1987 and the first quarter of 1988, all other factors being held constant, would have led to a decline in ethanol imports of about 10 million gallons annually (Chapter 5 in the Commission report).

- Based on the 1987 U.S. fuel ethanol market, it is estimated that increasing the indigenous feedstock level from a mandated 30 percent to a level of 75 percent would have increased employment in the CBI-ethanol industry by approximately 5,850 workers. However, this is primarily due to shifts in employment rather than to actual gains in CBI country employment.

Changing the indigenous feedstock requirement for CBI producers does result in the reallocation of cane workers from producing cane for sugar to producing cane for ethanol. However, the ethanol industry represents only a residual share of total demand for cane production. There is not a significant effect on employment of cane workers, but rather a reallocation of cane workers (Chapter 5 of the Commission report).

- Under 1987 U.S. fuel market conditions for fuel ethanol, it is estimated that increasing the indigenous feedstock level from a mandated 30 percent level to 75 percent would have resulted in a reduction of CBI-ethanol exports of over 9.4 million gallons and a loss to the economies of the CBI countries of over $700,000 per year. On the U.S. side it would have resulted in a loss of $9.3 million to U.S. consumers and a gain to U.S. producers of $4.1 million.

In 1987, while under a 30-percent indigenous feedstock requirement, the CBI countries exported 29.5 million gallons of fuel ethanol, valued at $28.8 million, had 11 plants in operation or planned, and employed in excess of 6,300 workers in the ethanol industry. Under recent past market conditions, a CBI-ethanol industry of comparable size would only be feasible under a feedstock requirement of 35 percent or less (Chapter 5 of the Commission report).

- A single indigenous feedstock requirement cannot compensate for all of the variations that occur in gasoline prices, European wet ethanol prices, and U.S. net corn costs.

A fixed indigenous content requirement cannot guarantee any given level of CBI-industry production or viability. To maintain CBI-ethanol industry viability, indigenous requirements must be varied with changes in other market conditions such as net corn costs, gasoline prices, sugar prices, and European wet ethanol prices (Chapter 5 of the Commission report).

In closing, whatever the final policy decision regarding indigenous feedstock requirements--continuation of the 75-percent requirement, total removal of the requirement, or some intermediate solution--other import relief trade laws which the Commission helps administer should continue to act as a safeguard in the event of unforeseen market developments. We will be pleased to attempt to answer any questions you may have. Thank you.

Chairman GIBBONS. Let me go back to Mr. Simpson, to those 6,000 jobs. Are those 6,000 additional jobs in the Caribbean or are those just 6,000 people who would be otherwise employed at something else?

Mr. SIMPSON. What we found basically was that if you do use indigenous feedstock in the form of sugarcane or molasses that is produced in a CBI country, you would have some shifting of cane field workers, for example, or sugar mill workers from sugar production into ethanol production. So it is more a reallocation of resources rather than an increase in actual employment.

There would be employment created in dehydration facilities, although it is limited to probably—I think the estimate is 25 to 30 employees per plant. And of course a fermentation facility, to the extent that they exist, would create more employment.

Chairman GIBBONS. Mr. Mendelowitz, of those three options that you presented, which do you think would be best? You studied it longer than anybody else, so I do not mind asking you that question.

Mr. MENDELOWITZ. Well, Mr. Russo made the statement a little while back that he writes the law. Ask Mr. Russo.

Chairman GIBBONS. But he does not sign the check. [Laughter.]

Mr. MENDELOWITZ. As all of the members of the respected Committee——

Chairman GIBBONS. I want an expert opinion. That is why I am asking. I am not asking him.

Mr. MENDELOWITZ. I will try to answer it as best I can. The reality is if you tell us what you want to achieve in terms of a policy, we can sit and evaluate how one goes about achieving those policy goals.

Chairman GIBBONS. Sure.

Mr. MENDELOWITZ. If you give us a mandate with conflicting policy objectives that cannot be achieved, it makes it virtually impossible for us to arrive at a recommendation for implementing those policy goals because they are mutually inconsistent.

And really the only answer I can give you is that, you know, if you want to remain true to the original intent of the CBI legislation——

Chairman GIBBONS. That is my intent.

Mr. MENDELOWITZ [continuing]. Then option two, which basically says go back to the status quo ante and put only those restrictions on ethanol imports that apply to all imports from the Caribbean countries covered by the Caribbean Basin Initiative program, that is all exports that were not specifically exempted from coverage when the Act was originally passed. If you want to protect the local industry from——

Chairman GIBBONS. The 35 percent——

Mr. MENDELOWITZ. The 35-percent value-added, yes.

If you want to protect the U.S. industry, at this point, given the current cost conditions, if you put a local feedstock requirement higher than 30 percent you will be able to squeeze the Caribbean producers out and there will be no imports from the Caribbean. If you want to strike——

Chairman GIBBONS. So the 30 percent, you say with everything as——

Mr. MENDELOWITZ. At current prices, a 35-percent local feedstock requirement would probably squeeze out almost all of the——

Chairman GIBBONS. Producers in the Caribbean?

Mr. MENDELOWITZ. Right. If you go to 35 percent, you will squeeze them all out probably for sure. If you want to strike a compromise between the competing demands, we have option three, which basically says grandfather in those companies that are producing. If you give them each a permanent exemption of 20 million gallons a year, the maximum they could export is 120 million gallons using wine alcohol. And quite honestly, we do not think they will come anywhere near that.

Now, these are all, you know, static conditions. Next year, everything could change. If the price of oil goes up appreciably, suddenly Caribbean ethanol using local feedstock could be competitive.

Similarly, if there is a change in the environmental laws which require a substantial increase in oxygenated fuel, you could overnight see a quadrupling of demand for ethanol or ethanol substitutes as additives to gasoline.

So there are all sorts of ways to cut it. And really I think the resolution is not asking me which option is the best. I think the resolution is you tell me what goal you want to achieve, and then I will give you the answer as best I can.

Chairman GIBBONS. The goal that I want to achieve is to leave the Caribbean Basin law as it was originally written.

Mr. MENDELOWITZ. Then option two is the preferred option.

Chairman GIBBONS. So that the value added requirement is 35 percent?

Mr. MENDELOWITZ. Correct. No requirement for local feedstock and subject ethanol imports to the same standard that all other covered imports from the Caribbean must meet, and that is 35 percent—it is a dual requirement. It is 35 percent local content plus the substantial transformation standard.

Chairman GIBBONS. Now, let me ask you: did you explore how much and how stable an import base of wine is available and what percent is consumed in this process in the Caribbean?

Mr. MENDELOWITZ. The European Community has somewhat over—or somewhere close to 300 million gallons of wine alcohol in its current inventory. It has a structural surplus that results from its intervention in agriculture currently of something like 100 million gallons a year. There may be a little bit more out there in private hands, but probably not a lot.

In 1988 the European Commission announced a program to dispose of most of these excess supplies. They wanted to sell 200 million gallons this year, and then basically over the next 3 or 4 years to sell off all of the remaining inventory so that they would only have on hand 1 year's surplus.

Chairman GIBBONS. Who else do they sell it to besides the——

Mr. MENDELOWITZ. It can be sold to any number of particular markets. There are industrial uses in Europe. There are fuel uses in Europe. There are other purchasers in the world for industrial uses and fuel uses. For example, all ethanol is not equally substitutable for every other kind of ethanol. Ethanol from sugar has a higher value on the market than ethanol from wine.

One report that we have heard is that because of the drought in Brazil, which has a transportation system heavily dependent upon ethanol, that what they might do is export the higher value added sugar cane based ethanol that is in short supply to Japan for industrial uses, and then enter the market and try to buy the Caribbean—I am sorry, the European wine alcohol and use that in their transportation system.

Chairman GIBBONS. Are you saying that the European Community is moving away from producing this pool of surplus every year? Is that what they are doing?

Mr. MENDELOWITZ. I would be—after seeing surplus production in a whole range of agricultural products in the Common Market and after seeing the extent of subsidized exports in grains and other commodities from the European Market, and the difficulty that they have had in coming to grips with this program despite its high cost, I am reluctant to say that I see the European market moving quickly away from subsidies and structural surpluses in any area.

Basically what they set out to do was to dispose of the excess supplies they have and try to reduce somewhat the structural surplus. To date, we are 4 months into 1989 and they have not sold off any of the wine alcohol yet. So they are well behind. They are never going to—I do not think they are going to make their target for disposing of what they want to dispose of in 1989.

Chairman GIBBONS. So you foresee, just from practical experience, that there will always be a surplus of European wine available to someone?

Mr. MENDELOWITZ. Well, I do not know always. Always is a long time.

Chairman GIBBONS. Well——

Mr. MENDELOWITZ. For the foreseeable future——

Chairman GIBBONS. OK.

Mr. MENDELOWITZ [continuing]. Next 3, 4, 5 years, I think there will be some surplus wine alcohol in the European Market.

Chairman GIBBONS. And what percent of that European wine alcohol ends up in ethanol?

Mr. MENDELOWITZ. Well, we estimated that we thought the Caribbean ethanol producers might be able to get somewhere between 30 and 40 million gallons a year of the wine alcohol for——

Chairman GIBBONS. 30 to 40 percent of the——

Mr. MENDELOWITZ. No, I am sorry, 30 to 40 million gallons of wine alcohol per year for processing into fuel alcohol.

Mr. PEASE. Will the gentleman yield?

Chairman GIBBONS. Certainly.

Mr. PEASE. How does that 30 to 40 million gallons compare with what they have been getting the last couple of years?

Mr. MENDELOWITZ. The Caribbean ethanol exports to the United States peaked in 1987 at about that figure. What was it 30—oh, 29 million gallons. So that basically that figure is not much larger than the maximum amount.

And as my colleague has pointed out, some of those exports do represent alcohol that was derived from fermentation of Caribbean cane. So it is, you know, maybe at most 10 million gallons a year more. They are buying less now simply because companies that did

not have the exemption under the Act are not able to export and therefore are not buying the commodities.

Mr. PEASE. Thank you, Mr. Chairman.

Chairman GIBBONS. Fine, go ahead.

Let us go to Mr. Russo.

Mr. RUSSO. Go ahead.

Mr. MATSUI. I would like to follow up your question on the wine surplus issue. When you said that, given your study of the European Community and the fact that it has heavily subsidized agriculture, you were not implying that necessarily that you foresee this thing going on indefinitely. Were you basically saying you just do not know?

Mr. MENDELOWITZ. That is right.

Mr. MATSUI. It could be cut off in 1992 or it could be continued indefinitely. If Secretary Hills is successful, you could see a significant decrease in subsidies.

Mr. MENDELOWITZ. Yes.

Mr. MATSUI. Does that cover your answer?

Mr. MENDELOWITZ. No. I think that is a correct answer. I think the United States put forward a very far-sighted proposal in this round of the GATT negotiations which basically tried to eliminate government subsidies on the part of all governments in agriculture. And basically the European Community was not interested in that proposal, but—and I guess the reason it was not interested is that their agriculture interests are quite strong and they just have had great difficulty in making progress in reducing subsidies.

Mr. MATSUI. So basically you are saying that you just do not know what the future is in terms of any excess wine alcohol available?

Mr. MENDELOWITZ. Right.

Mr. MATSUI. Now, if I may, Mr. Chairman, assume that our domestic market begins to expand because of air quality standards, and assume more competition in the U.S. market and a stable supply, which in turn results in an increase in gasohol stations and those kinds of things. Obviously the Caribbean countries then could increase their output of ethanol, but does that mean that they will be able to get an unlimited supply of wine?

Mr. MENDELOWITZ. I do not think so. The current structural surplus in the Common Market is, I think we said about 100 million gallons a year. And the current U.S. ethanol sales are over 800 million gallons a year. There is no reason to believe that the Caribbean producers would somehow be able to buy all of the structural surplus from the Common Market. And so basically, with respect to expanding markets, I think one of the proposals made by the Caribbean producers when we visited with them was that they would like to expand into markets where United States producers currently do not sell. For example, the East Coast is not a big market for ethanol. They felt that they could ship competitively to the East Coast markets and basically create a new market for ethanol.

Mr. MATSUI. The last question I have then is a follow up to that.

From 1985 to 1988 they had a significant use of surplus European wine alcohol in the Caribbean countries. And that accounted for no more than 4 percent of the U.S. market.

Mr. MENDELOWITZ. Correct.

Mr. MATSUI. So you do not foresee any expansion of that 4 percent in terms of European wine alcohol?

Mr. MENDELOWITZ. Suppose for argument's sake they got the full 100 million of the structural surplus.

Mr. MATSUI. Right.

Mr. MENDELOWITZ. If they got all of that, for argument's sake, and they could process it and there was no decrease in volume through processing—obviously there is a decrease, a loss—even if they got all of it and sold it in the United States and the U.S. market did not expand at all, that that would represent I think, what, 12 percent of the U.S. market. In the worst of all possible worlds, that is the maximum market penetration.

Mr. MATSUI. Thank you.

Chairman GIBBONS. Marty.

Mr. RUSSO. What would they use if they did not use wine alcohol to make up the difference?

Mr. MENDELOWITZ. It depends on the price cost relationships. Basically at current price-cost relationships, they would not produce anything. If you look at——

Mr. RUSSO. But a year from now it may be very profitable.

Mr. MENDELOWITZ. A year from now, if for example sugar—if you look back over the 1980's, sugar fluctuated on the world market from a high of 29 cents a gallon to a low of 4 cents a gallon—I am sorry, a pound, a high of 29 cents a pound to a low of 4 cents a pound.

If the price suddenly of sugar on the world market were to drop to 4 cents a pound, they could use local feed stock probably and compete in the U.S. market using that local feed stock. If the price stays where it is now, 12 to 15 percent, they would not produce any and they could not compete——

Mr. RUSSO. 12 to 15 cents you mean?

Mr. MENDELOWITZ. I am sorry, 12 to—if it stayed currently at the 10 to 12 cents per pound level, or increased to 15 cents a pound, they could not produce alcohol and compete in the U.S. market unless there was a very substantial increase in the price of petroleum.

Mr. RUSSO. And there may be that?

Mr. MENDELOWITZ. Possible.

Mr. RUSSO. I guess the biggest problem is none of us can predict exactly what our needs are going to be, what our economic circumstances are going to be. You can only make a prediction today on what you know?

Mr. MENDELOWITZ. That is right.

Mr. RUSSO. And what you can conclude under the requirements of law it is just not feasible for them to do it?

Mr. MENDELOWITZ. Yes.

Mr. RUSSO. The question is whether this Committee says under the current circumstances we want to make it feasible for them by eliminating certain requirements. That is the decision we have to make.

Mr. MENDELOWITZ. Yes.

Mr. RUSSO. A year from now we may be coming back in here and saying, everything went up, it is out of control, now we have got to

get back and reign them in. That is a nice policy to have going for these people to know from year to year, if they get in the high end in one group in this Committee, they face a problem, if they get in the low end with another, they have got a problem. So that is—that gives them a lot of stability in their business.

Mr. MENDELOWITZ. I think that—I mean of the reasons why this all arose as a problem is that during the period since the Caribbean Basin Initiative legislation was passed, there has been a very substantial alteration in the prices of the commodities that enter into these——

Mr. RUSSO. That is one of the reasons why actual import levels are down, because they do not know under what rules they are playing. As soon as they know, if it is European wine, they will flood the market again. And if it is not European wine, they are out of the market.

Mr. MENDELOWITZ. Well, I do not—based on our estimates of what is available, I do not think they can flood the market.

Mr. RUSSO. What I mean by flood the market is use the nonindigenous feedstock very successfully.

Mr. MENDELOWITZ. That is right. If——

Mr. RUSSO. That is what they would do right now if we continue this requirement?

Mr. MENDELOWITZ. If you revert to the original provision of the Caribbean Basin Initiative, they would resume production of ethanol from wine alcohol if they can get supplies. I mean right now they are having a lot of trouble getting supplies. But we do——

Mr. RUSSO. But you are not sure whether that supply is going to be ample? It could be very good. It depends on how much the European Community decides to subsidize their——

Mr. MENDELOWITZ. Yes.

Mr. RUSSO. OK. So I mean, we do not have——

Mr. MENDELOWITZ. If I might point out, it is—the subsidy is not in the selling off the surplus. The subsidy has already been paid because——

Mr. RUSSO. They are just trying to recoup anything they can for what they have got?

Mr. MENDELOWITZ. They are getting out from under the storage costs.

Mr. RUSSO. If they pay their growers $5 a gallon, if they get 25 cents, they are 25 cents ahead because they would not get anything else for it?

Mr. MENDELOWITZ. They are ahead 25 cents, plus they saved their storage costs.

Mr. RUSSO. Right, whatever. I understand that. I think the committee does too.

I think the ITC said that, from 1985 to 1988 approximately 68 percent of the fuel ethanol imported from the Caribbean Basin countries was produced from surplus wine alcohol, is that right?

Mr. MENDELOWITZ. Yes, sir.

Mr. RUSSO. They used—basically 68 percent was wine alcohol. The rest was indigenous I assume.

Let me ask you: if we go back to option two, which is the 35 percent value added, one of the concerns you raised I would like you to comment on, is that if you—and you stated in your report on

page 22, under a value standard, companies might try to use transfer pricing to boost the value of the local imports. For example, a subsidiary of the company that produces feedstock could charge a high price for local feedstocks to another subsidiary of the same company that uses the feedstock to make fuel ethanol. In this way, the company would use less local feedstock than they otherwise would.

So, a game can be played, and I think what we realized back in 1986 when we put these requirements in that we were concerned about some of these kind of games and the things that Byron Dorgan raised about people who benefit from this are not necessarily the local people, but people who build the plants.

Mr. MENDELOWITZ. I might point out that what we were discussing on page 22 was all the risks associated with alternative strategies for setting standards, the strengths and the weaknesses of using a value standard versus a volume standard. And we tried to be as complete as we could in the discussion.

Mr. RUSSO. Well, I appreciate that. And that obviously raises a red flag on what one of the problems may be by using the 35-percent value-added, they can play a game and get around that requirement.

If you are talking about benefiting the Caribbean, where is the most employment, in dehydration facilities or in full fermentation? And what are the differences?

Mr. MENDELOWITZ. Well, I think as we said both in our statement and in our report, if you take a 20-million-gallon-a-year facility and compare the employment associated with a dehydration facility versus a full fermentation facility, you find that a dehydration facility employs 25 to 30 people and a full fermentation facility will employ close to 1,000, including seasonal workers who you would need at harvest time for the sugarcane.

I think there is no question that if the choice is between producing ethanol through full fermentation versus dehydration of wine alcohol, you get much more bang for the buck in terms of employment and local benefits if you are using full fermentation. But if under the current economics, full fermentation is not possible, then the choice is between no employment, no economic benefits at all versus whatever employment and economic benefits accrue to dehydration.

Mr. RUSSO. In researching the statute, did you find where the Congress said that under all circumstances they must guarantee the Caribbean countries a part of the ethanol market, that they were guaranteed that regardless of the cost?

Mr. MENDELOWITZ. I do not think that in the—I could be wrong, but I do not think that in the legislative history of CBI there was a discussion of ethanol.

Mr. RUSSO. It did not say—did it say anywhere that you—that under certain pricing mechanisms there was a better deal, and therefore we want to make sure they do it, and under other pricing methods it may be a bad deal? You did not come across that, did you?

Mr. MENDELOWITZ. I am not an expert on the legislative history of the CBI, so I——

Mr. RUSSO. But you do a lot of research, independent research, to find out what is going on.

Mr. MENDELOWITZ. No, we did not come across that.

Mr. RUSSO. I figured you did not. I would not have asked you the question if I thought you did. [Laughter.]

Chairman GIBBONS. Mr. Mendelowitz, before I go to the next member, let me just ask one question. As I recall your testimony, you said that if the Caribbean was able to acquire all of the European surplus wine and convert all of the European surplus wine into ethanol and exported it into the United States, it would still only amount to about a 12-percent penetration of the U.S. market?

Mr. MENDELOWITZ. Well, the current annual structural surplus in the European Community is about 100 million gallons a year of wine alcohol. Therefore, if the U.S. market were not to increase at all——

Chairman GIBBONS. Yes.

Mr. MENDELOWITZ [continuing]. And the Caribbean producers were able to secure that 100 million, and they were able to improve their facilities so they could in fact process it all——

Chairman GIBBONS. Yes.

Mr. MENDELOWITZ [continuing]. That would be the upper limit on an annual basis.

Chairman GIBBONS. 12 percent of the current U.S.——

Mr. MENDELOWITZ. Yes, 12 percent of the current U.S. market.

Chairman GIBBONS. OK, fine.

Now, who is next? Whoever is next. We will let you all wrestle it out. Mr. Pease.

Mr. PEASE. Thank you, Mr. Chairman.

I would like to thank both of our expert witnesses and their colleagues.

I have a question for Mr. Simpson.

Mr. Simpson, in your testimony on page 5 you say in the second paragraph, underlined: "Based on the 1987 U.S. fuel ethanol market, it is estimated that increasing the indigenous feedstock level a mandated 30 percent to the level of 75 percent would have increased employment in the CBI ethanol industry by approximately 5,850 workers." And you go on to point out that it would be primarily shifts in employment rather than actual gains in CBI country employment.

If you had a 30-percent mandated local level, would that not make the industry uncompetitive, and therefore you would have zero employment in that industry?

Mr. SIMPSON. Our findings, sir, were that given market conditions that existed in 1988, you would have to set the indigenous requirement at 35 percent or less to get the level of exports that existed in 1987, which is the peak year of exports. Because this particular industry in the CBI is made up of so few firms, what actually happens is very dependent on the decisions by the individual firm. So the possibility does exist that firms might stop producing or produce only very sporadically.

Mr. PEASE. Well, we have been told by the GAO that to make the requirement 75 percent, you close down the industry?

Mr. FRANCOIS. Again, we are talking several different—we are talking 1987-88——

Mr. PEASE. Let us talk about 1987. That is what you say in your paragraph right there.

Mr. FRANCOIS. Our analysis was based on market conditions in the second half of 1987 when gasoline prices had actually risen a bit from earlier in the year. Corn prices were such that during the second half of 1987 the Caribbean industry was exporting at a clip of about 18 million gallons, which is what, about 36 million for the whole year, considerably more than they were in the first half. And conditions were in effect more favorable in the second half of 1987.

And what this is referring to is under those market conditions, if we were to raise it to 75 percent—if we were to try to maintain the export levels they have for the whole year, which was 29 million for the full year, then it would have to be 35 percent or less.

Now, again, that is based on market in the second half of 1987. And in fact they were less favorable in the first half of 1987. Gasoline prices were lower. The price of oil was lower at that point. And across the whole of 1987 they probably would not have been able to replicate that, that level of export with the 30- or 35-percent requirement.

Mr. PEASE. What you are suggesting here is that if there is a 75-percent requirement, as long as oil prices are reasonably firm, there can be a shift to local indigenous production of feedstock, i.e. sugar cane that will employ 5,850 workers.

Mr. FRANCOIS. OK, two things here. One is some plants will be producing at that level. As Mr. Simpson pointed out earlier, there are only a few producers here. And as we see the climb in the level of production costs, some plants are probably going to be shutting down completely. So you are saying, well, yes, there will continue to be employment in some pockets, while some of these other plants will probably end up shutting down completely.

In addition, ethanol is a rather small share of the Caribbean sugar market. They account for a very small share of sugar production. And as a result they are not going to have a dramatic effect on the price of sugar or the health of the sugar market with what is happening here.

In effect, sugar that is on the market already is being used for ethanol as opposed to being used for other purposes. And in that sense you are shifting employment.

Cane workers that are working anyway are supplying sugar for these mills, for these fermentation facilities, instead of supplying it to wherever else it may have been purchased in the world market.

Mr. PEASE. I wish that you would go back and look at that again and perhaps send the committee a letter, or at least send me a letter.

Mr. FRANCOIS. Certainly.

Mr. PEASE. They are telling us that it would increase employment by 5,850 workers. I am posing a 75-percent feedstock, domestic feedstock level. I can't follow how that could occur. It's hard to believe that ethanol from sugarcane is quite competitive with what they're doing now, but beyond that, how is the local economy going to produce the fermentation plants to manufacture enough ethanol to employ 5,850 people extra?

Well, you don't have to answer now, but if you would——

Mr. FRANCOIS. We will get something to you.

Mr. PEASE. Would you look that over and send me a letter explaining that please?

Mr. FRANCOIS. Certainly.

[The following was subsequently received:]

CHAIRMAN

UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, D.C. 20436

May 1, 1989

Honorable Donald J. Pease
United States House of Representatives
2410 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressman Pease:

Pursuant to your request during the April 25, 1989, Subcommittee on Trade hearing on fuel ethanol imports, attached is additional written explanation of the Commission's study results regarding the consequences for CBI ethanol producers of adopting a 75 percent indigenous feedstock requirement.

Please continue to call on us whenever we can be of assistance to you.

Sincerely,

Anne Brunsdale

Anne Brunsdale
Chairman

Enclosure

cc: Chairman
Congressional Liaison
Office of Industries

April 25, 1989, Subcommittee On Trade Hearing on Ethanol Imports from CBI Countries

Request for Information (made by Congressman Pease)

Request: The Commission staff was asked by Congressman Pease (Ohio) to provide additional written explanation on the Commission's model results with regard to the consequences for the CBI industry of going to a 75-percent indigenous feedstock requirement.

ITC response: The Commission's estimate of the effect on the U.S. and CBI economies of going to a 75 percent indigenous feedstock requirement are based on information about the costs of production for CBI producers, and what increasing the feedstock requirement will do to these production costs. These changes in production cost are then assumed to be passed through to consumers. Given estimates of the sensitivity of import demand to price changes, we then simulated the effects that these price increases have on demand. Further information on our findings and the rationale behind them are provided below.

- Based on evidence we observed in our investigation, and on testimony heard at the Subcommittee on Trade hearing, the U.S. industry can not meet current U.S. ethanol demand. In fact, there will be some demand for CBI ethanol, even at significantly higher prices. In the past, CBI producers have sent small shipments to meet "peak" or "swing" demands at a wide range of prices, including prices much higher than the average market price.

- Had a 75-percent feedstock requirement been imposed in 1987, there would have been a significant increase in the average CBI cost of production, and a dramatic decline in export levels. In the second half of 1987, CBI producers sold approximately 18 million gallons of fuel ethanol in the United States, at a price of approximately $1.06 per gallon. These exports were almost all grandfathered, and were thus produced under the original 35-percent value added requirement. Had the grandfathered producers been required to comply with a 75-percent feedstock requirement, according to our model estimates, exports over those six months would have fallen to about 9.45 million gallons (or 18.9 million gallons annually), and would have been sold at a price of about $1.37 per gallon. 1/

- Changing the feedstock requirement would likely have the combined effect of dramatically increasing costs for the CBI as a whole and reallocating production among CBI producers. In addition, it is likely that dehydration-only facilities would have to shut down under a 75-percent requirement. Costa Rica and Guatemala would likely account for a significantly larger share of the much smaller total export market; most capacity for producing ethanol from fermentation is located in Costa

---

1/ During the third and fourth quarters of 1987, the principal domestic producer's average prices were $1.20 and $1.09, respectively.

Rica (the CATSA and Taboga facilities owned by LAICA), El Salvador (including the El Carmen and La Cabana facilities), and Guatemala (with a full fermentation facility at El Palo Gordo). There is enough capacity at these facilities to meet a U.S. demand of 15 to 20 million gallons per year. These facilities have a combined capacity of almost 250,000 gallons per day. Petrojam's Bernard Lodge fermentation facility might also be able to compete. It is likely that production at fermentation facilities would be sporadic and highly dependent on existing market conditions. The dehydration-only facilities in Jamaica, as well as the planned plants in the Bahamas and U.S. Virgin Islands, would not likely be able to compete effectively in such a market.

- In terms of employment, the effects are mixed. Increasing the feedstock requirement will mean that whatever CBI production remains will use significantly more cane as a feedstock. However, this will still represent a very small share of sugar cane production, and will have little or no effect on the price of cane or employment of cane workers. Rather than plant new cane, it is likely that, over the next three to five years, existing production will simply be diverted to the fermentation facilities, and skilled labor that had supported the processing of cane for sugar will instead support the operation of fermentation facilities. For example, LAICA could possibly divert molasses or cane juice at its CATSA and Taboga facilities to ethanol production. This diversion of cane use was reported by USITC as a reallocation of labor to ethanol production. (The 5,853 jobs referred to in the report essentially represent the number of already-employed cane workers whose production goes to ethanol instead of sugar). It does not represent the creation of a significant number of additional jobs. In terms of net employment changes, the significant effects will be felt at dehydration plants that would likely be closed down. At these facilities, there may be the loss of 60 to 70 jobs.

Mr. PEASE. Thank you.

That's all, Mr. Chairman.

Mr. MATSUI. Mr. Chairman, may I follow up? Who really got into the domestic industry, Mr. Simpson or Mr. Mendelowitz?

Mr. MENDELOWITZ. I think we both had the same charge.

Mr. MATSUI. Assuming that it's going to be U.S. policy because of air quality problems, to reduce carbon monoxide emissions and increase the standards. We would begin a major policy to encourage ethanol fuel throughout the United States. Right now we are subsidizing the few companies in the United States that produce ethanol.

Is this correct?

Mr. MENDELOWITZ. To a rather substantial degree.

Mr. MATSUI. I understand.

Both through tax incentives at the plant, and through the pump.

Now, in your opinion, would it be in the interest of the United States to have more competition in that situation? Because with each additional gallon of ethanol being produced, the U.S. Treasury is just going to have to subsidize that product more, is that correct?

Mr. MENDELOWITZ. Under the current circumstances, ethanol as a fuel is only competitive when subsidized.

Mr. MATSUI. Right.

Mr. MENDELOWITZ. If, for environmental reasons, the Government were to mandate an ethanol percentage in gasoline, to reduce pollution, that may be 3 percent, you could probably do away with the subsidy because the mandate would create the demand for the product, at whatever price the market required to supply it.

So, if you require it, you don't have to subsidize it.

Mr. MATSUI. Oh, so we could then eliminate the subsidy, because the price will go up?

Mr. MENDELOWITZ. Yes.

Mr. MATSUI. Well, then, would it not be in the interest of our consuming public to have some competition in addition to the few companies that apparently produce ethanol? From a competitive perspective?

Mr. MENDELOWITZ. I think as a general proposition, the U.S. Government takes the view that competition serves the interest of the consumer.

Mr. MATSUI. Well, we used to think that.

Mr. MENDELOWITZ. And I think that it is a logical conclusion from the way you've raised the question.

Now, I would say, though, if we went to something like, say, a 3-percent requirement for ethanol in fuel and gasoline, it would create such an explosion in demand that we just wouldn't have the capacity to meet it in the short run. We'd need all the ethanol that we could find, and then probably a big chunk more.

Mr. MATSUI. Because otherwise a few domestic producers that will make quite a bit of money.

Mr. MENDELOWITZ. It's not just that. They don't have the capacity.

Mr. MATSUI. Right.

Mr. MENDELOWITZ. Because, for example, fuel ethanol made from corn is only one use of the corn product, but the other alternative is high fructose corn syrup.

If you increase demand for ethanol, we shift more corn production into fuel, there is going to be decreased production of high fructose corn syrup; there is going to be a demand for increased sugar; the price will go up, and maybe we'll import more from the Caribbean, and we'll get the sugar in that way instead of through ethanol.

Mr. MATSUI. I appreciate your answer.

What really troubles me about this whole issue, Mr. Chairman, is that it seems that some domestic producers of ethanol are trying to keep the market very limited. I think they foresee that we are going to need more ethanol because of air quality problems throughout the United States, and they see a real windfall. That's why we need some competition, and I think that's exactly why they are trying to keep ethanol out of the Caribbean countries.

Mr. RUSSO. Would the gentleman yield?

I guess knowing how we function here, if we see there is a lack of competition, and we need a tremendous demand, and we do, in fact, pass the laws that increase it to the 3-percent requirement, there wouldn't be any problem with us making it easy for the Caribbean countries to get into it. You can just give them a better deal than they have today.

You know, you are trying to anticipate that there may or may not be something like that in the future and to ascribe whatever motives you want for the companies that are there. I think it is terrible to allow people to go into the Caribbean and pass through European wines so they can make a great deal of money, and not the individual country and the people that you are theoretically trying to benefit.

So, I mean, there's——

Mr. MATSUI. If I could just reclaim my time.

I would only say that the Congress ought to be thinking proactively, rather than reactively, because too often we react instead of think long-term. I think the approach to allow these companies to continue in the Caribbean would be looking proactively to the future rather than waiting 5 years and reacting while allowing a few countries to make a windfall in the United States.

Chairman GIBBONS. Any further questions?

[No response.]

Chairman GIBBONS. Thank you, gentlemen, very much.

We now have an interesting panel, Renewable Fuels Association and Tropicana Industries—Lin Shepard, chairman of the board, with A.E. Staley Co.; and Mr. William Maloney, general manager of Jamaican Operations of Tropicana Energy Co.

Let's make sure the record shows Tropicana Energy Co. is not the same as Tropicana Orange Juice Co. There's no connection, is there?

Mr. MALONEY. No.

Chairman GIBBONS. All right, gentlemen, we'll hear from you first.

STATEMENT OF LINDEN SHEPARD, VICE PRESIDENT, A.E STALEY CO. AND CHAIRMAN, RENEWABLE FUELS ASSOCIATION, ACCOMPANIED BY ERIC VAUGHN, PRESIDENT

Mr. SHEPARD. Thank you, Mr. Chairman.

Good afternoon, my name is Lin Shepard. I am chairman of the Renewable Fuels Association and also a vice president of A.E. Staley Manufacturing Co.

Staley is one of the larger corn refiners in the United States, and at the risk of bragging a bit about my company, I am happy to say we have always been on the leading edge of technology in corn refining.

And with emphasis on advance technology, the company manufactures and markets a wide range of products from corn, including ethanol for use as an octane enhancer in motor fuel.

Chairman GIBBONS. Are you a competitor of Archer Daniels?

Mr. SHEPARD. I sure as hell am.

The Renewable Fuels Association is the national trade association for the domestic ethanol industry. The association's primary objective is to establish through legislation and regulations economic and marketplace conditions favorable to the production and use of ethanol.

On behalf of the RFA, I want to thank the members of the committee for allowing me to appear here, and giving me the opportunity to testify on the CBI.

Since the inception of the CBI, the industry has supported not only the program but the production of ethanol in the Caribbean countries, provided that that production was from indigenous feedstocks.

Our policy on that is very consistent with the goals and the objectives of the CBI Program. Now, when the program was enacted, we thought that the stated objectives would encourage the economic development of the beneficiary countries and to create meaningful employment through the maximum utilization of natural resources of those countries.

And we think an ethanol industry using indigenous feedstocks would provide the type of growth envisioned by Congress.

Now, what we have here today, it seems to us, is something different from that. What we have are maybe three issues:

The issue of surplus, subsidized, cheap European wine alcohol versus indigenous feedstocks. We have the issue of representations and promises by dehydrators versus what has actually transpired, and we have the issue of hurt of the domestic ethanol industry versus profiteering opportunities for the dehydrators.

Now, I give the dehydrators very high marks for being very good entrepreneurs, being very opportunistic, being good businessmen. They sought a mechanism, a loophole in the original CBI Program, sought a ruling from Customs, obtained that ruling that allowed them to use heavily subsidized wine alcohol as the primary feedstock for CBI ethanol that created a virtual dumping franchise.

Now, that was not the intent. So, in 1986, recognizing that there was some undermining of the original intention of the CBI, Congress sought to stop the mere dehydration of wine alcohol, and once again encourage the use of indigenous agricultural feedstocks.

In reliance on statements made by all the dehydration companies, Congress agree to allow time for these companies to scale up to a full fermentation operation. The scale-in program was intended to stop the mere dehydration and make the companies begin full fermentation. That has not happened.

I don't believe there is any more productive capacity in the CBI today for full fermentation than there was in 1986. I may be wrong on that. I don't believe 1 gallon of additional full fermentation capacity has been brought on string.

Now, the issue is, who gets hurt by this? And who profits by this? And there has been conversation today that we are talking about a 3-percent national market penetration. But when you grandfather a group of companies, when you give a group of companies the right to 100 million gallons, that's potentially 12 percent. So, I have to assume that ultimately it will be 12 percent and not 3.

The other thing I would say about 3 percent is Staley produces ethanol in Tennessee, and then we sell in the Southeastern United States. And I can tell you it has felt to us, from time to time, that all 3 percent comes into the Southeastern United States, because using this wine alcohol, in effect that dehydrators become the world's low-cost producers. And almost through predatory pricing, they just bring the market down around our heads.

And so I'm hurt. And why else, on an issue that is fairly simple would there have been so many words written? So many words spoken? We have comprehensive, and you know complete studies by the ITC and the GAO. I don't know how many words have been spoken about this, but somebody's getting hurt.

Well, I'm that somebody, and I'm a medium-sized producer; and the small producers are getting hurt. Now, I'm not worried about my major, my largest competitor. I don't worry about them. I worry about my company. I'm worried about the small producers, because some of them have folded up.

And if you want more competition, it would seem to me that you would want to do things to encourage the small producers back into the market, not to do things that are going to keep them out.

So, we're hurt.

Now, why are the five trading companies so adamant, so forceful in pursuit of this? Somebody is making a bundle of money on the simple dehydration.

I can tell you dehydration versus a total fermentation ethanol plant. We are not talking the same thing. It's like two different themes, and in the simple dehydration, it changes the game, it makes the playing field very uneven, and we hurt, and I believe they profit handsomely.

Thank you.

[The statement of Mr. Shepard follows:]

Renewable Fuels Association
201 Massachusetts Avenue, N.E.
Suite C-4
Washington, D.C. 20002
(202) 543-3802
TELEFAX: (202) 543-6925

Eric Vaughn
President/Chief Executive Officer

Testimony of

LINDEN SHEPARD
VICE PRESIDENT
A.E. STALEY COMPANY

and

CHAIRMAN
RENEWABLE FUELS ASSOCIATION

before the

HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON TRADE

APRIL 25, 1989

INTRODUCTION

Good afternoon, my name is Linden Shepard, Chairman of the Renewable Fuels Association and Vice President of the A.E. Staley Company. On behalf of the members of the Renewable Fuels Association, the national trade association for the United States fuel ethanol industry, I want to thank the members of the House Ways and Means Committee for this opportunity to testify on the issue of Caribbean ethanol.

1989 marks the 10th year in which ethanol has been commercially produced and blended in the United States. In 1978 Congress passed, and the President signed the Energy Tax Act. That act exempted 10% ethanol blends from all four cents of the federal excise tax on gasoline. Today ethanol is exempt from six cents of the nine cent federal excise tax. Ethanol also enjoys additional state tax incentives which are provided to petroleum marketers in 18 states across the country. In 1988, ethanol blended fuels were sold by petroleum marketers in forty-two states. Each gallon of ethanol contains the detergent and corrosion inhibitors requested of gasoline marketers by General Motors and other major automobile manufacturers.

During the 1970's, nearly 300 legislative initiatives were passed by state legislatures all across the country promoting the production and use of ethanol fuels. States such as Iowa, Nebraska, Kansas and Illinois enacted progressive alternative fuels legislation long before the U.S. Congress held its first hearing on ethanol. The States have always led the way on legislation and regulations designed to encourage the production and marketing of ethanol blended fuels.

By 1979, the federal government had established a comprehensive program to promote the manufacture and use of ethanol fuels produced from renewable resources. As a direct result of federal tax incentives, investment tax credits and federal environmental regulations, over 100 ethanol production facilities capable of producing over 1.2 billion gallons of ethanol were constructed with a private sector investment in excess of $2.5 billion. Federal energy policies designed to support the development and commercialization of ethanol fuels

are consistent with national efforts aiding the commercial development of other energy technologies such as hydroelectric, solar, nuclear and petroleum.

These incentives were established by the Congress and the states to enable ethanol blended fuels to be competitive with regular and premium grades of gasoline in the marketplace, and to assist the development of an alternative fuels industry. Numerous studies and reports including the White House Task Force on Alcohol Fuels, the 1987 National Panel on Ethanol Cost Effectiveness and the recent Congressional Research Service analysis of ethanol's costs and benefits strongly endorse government efforts to promote ethanol. These reports also state that the cost of federal incentives to ethanol blenders and marketers are more than offset by federal budget savings in lower federal farm program costs.

This year alone, the production of ethanol will utilize nearly 360 million bushels of corn in the United States, adding $1 billion to farm income while reducing federal farm program costs by $700 million. In the process of converting corn to ethanol, ethanol producers are providing the petroleum industry with a high-octane, high performance, environmentally-improved motor fuel which allows marketers to increase their product flexibility and profit margins. Ethanol blended fuels provide city managers with one of the most effective tools available in the war against carbon monoxide and ozone pollution levels. Finally, the production of ethanol has provided the opportunity to reinvigorate rural-agricultural based economies all over the nation.

The Renewable Fuels Association's primary objective is to establish, through legislation and regulations, economic and marketplace conditions favorable to the production and use of ethanol. In addition, we are dedicated to providing the most technically accurate and up to date information on ethanol blended fuels to consumers, blenders, marketers and technicians alike.

The Association includes members from a broad cross-section of companies and organizations involved in the renewable fuels industry, including ethanol producers whose combined production exceeds 95% of all U.S. produced fuel ethanol as well as marketers, equipment manufacturers and other organizations that have an economic interest in the development of the fuel ethanol industry.

In addition to our efforts as a trade association, the RFA members have established a non-profit Foundation designed to enhance public awareness and understanding of the renewable fuels industry. The Foundation's general purpose is to meet an expanding demand for technical information and up-to-date research on developments in alcohol fuels and other fuels produced from renewable resources.

One of the Foundation's most successful projects to date has been the preparation and distribution of a technical manual on ethanol designed specifically to meet the needs of auto mechanics and car care specialists, Changes in Gasoline and the Auto Service Technician. Over 250,000 manuals have been distributed nationwide to auto service technicians, service managers, vocational schools and fleet administrators. It has served as the basis for seminars on fuel quality around the country, as well as being made an integral part of courses at a number of vocational schools and training centers. Recently, a video version of the manual was completed to facilitate its incorporation into training programs throughout the country.

The Renewable Fuels Foundation also commissioned the Systems Applications, Inc. (SAI) study, An Evaluation of the Impact of

Ethanol/Gasoline Blends on Urban Ozone Formation. This study has provided valuable and positive scientific information regarding the impact of ethanol blends on ozone levels and represents an enormous opportunity for communities seeking consumer acceptable options to reduce both carbon monoxide and ozone.

The RFA and the Foundation have recently completed the most comprehensive test of ethanol blend fuel use in 2-cycle engines ever conducted. The 1988 Field Evaluation of Small Engine Lawn & Garden Equipment Operated on Gasoline Containing 10% Ethanol provides two cycle engine manufacturers with the most up-to-date technical information regarding the use of ethanol blended fuels.

The combined efforts of the Association and the Foundation have done much to promote ethanol as the most significant alternative fuel available in the United States today. From just 10 million gallons of annual production in 1980, U.S. ethanol fuels output is expected to rise above 900 million gallons this year, with ethanol blends accounting for roughly 8% of total U.S. gasoline sales. Every automobile manufacturer in the world provides full warranty coverage for the use of 10% ethanol blended fuels. Motorists have traveled over 600 billion miles using ethanol blends, clearly establishing their marketplace acceptance. Moreover, the benefits its use delivers in terms of energy security, balance of trade, agriculture, and environmental impact assure its continued use for years to come.

Fuel ethanol has become the most significant new alternative fuel on the motor fuel marketplace in 10 short years. The benefits derived from fuel ethanol include the following:

1. Refiners are able to extend their fuel supplies, run their refineries less severely and gain a valuable source of octane.

2. Gasoline marketers gain valuable octane which improves their profitability and product flexibility.

3. Consumers gain improved vehicle performance, increased motor fuel octane at more competitive prices.

4. The public gains improved air quality that results from using ethanol blended fuels, increased energy security and enhanced economic opportunities for our agricultural sector.

STATUS OF THE DOMESTIC ETHANOL INDUSTRY

This year, we estimate that 900 million gallons of ethanol will be produced in 55 production facilities located in 23 states. Ethanol blended fuels will be marketed as a high value, high octane fuel additive in 42 states. The 55 operational U.S. ethanol production facilities have an annual production capacity of 1.05 billion gallons. In other words, while ethanol fuel sales will likely climb above 900 million gallons this year, current production capacity exceeds current demand by an estimated 155 million gallons annually.

It is also important to point out that in addition to the 55 operational ethanol production facilities in the U.S. there are 50 facilities that are not currently operational. Of the non-operational facilities, 34 are considered down temporarily and could technically reopen within a year. These plants represent approximately 160 million gallons of production capacity.

It has been reported in numerous trade journals that several operating plants are in the process of expanding their plant capacity and 25 new plants are currently at one stage or another of planning, financing or under construction with a total potential capacity of over 650 million gallons. The production

capacity of the domestic ethanol industry has grown steadily over the past ten years to meet anticipated demand. Investments in new plants, the most advanced equipment and the latest technology are excellent examples of our industry's commitment to producing the highest quality ethanol at the lowest possible price to meet market demand.

Ethanol blends have captured an ever increasing share of total gasoline sales in the United States. In ten years the total market share of ethanol blended fuels has climbed from zero to over eight percent, a remarkable growth record. A review of gasoline/ethanol blend sales by region and by state provides clear evidence of ethanol's role as an octane enhancer and high quality fuel extender in motor fuel markets all over the country. It is important to note that the midwestern states are by far the largest producers and users of ethanol blended fuels. The largest volume blend sales in occur in Illinois, Iowa, Nebraska and Ohio.

The nation's midwestern states have provided a variety of state tax incentives, favorable blending laws and pump labeling regulations to encourage the marketing of ethanol blended fuels and to attract ethanol production facilities to their states. The Nation's leading agricultural states have worked to enhance the production and use of a ethanol to add value to farm crops and create alternative markets for the region's agricultural abundance. However, while midwestern states have led the development of the domestic fuel ethanol industry, ethanol is marketed today in 42 states nationwide. Market penetration levels of ethanol blends exceed 10 percent of all fuel sales in each of the following states: Kentucky, Illinois, North Dakota, Nebraska, Iowa, Alabama, Ohio, Nevada, Indiana, Kansas, South Dakota, Minnesota, Tennessee and Virginia. Market penetration levels of ethanol blended fuels are greater than five percent of all fuel sales in New Mexico, Michigan, Oklahoma, Texas and Colorado.

From Florida to California and Minnesota to Alabama, over 900 million gallons will be sold this year. The most exciting and dramatic new growth in market sales of ethanol blended fuels is taking place in large metropolitan areas seeking clean burning, low pollution fuel alternatives to help reduce carbon monoxide levels. The claim by some that ethanol is marketed only in midwestern states because it is "uneconomical to ship to the coastal markets" or because of "competition from major oil companies" is particularly specious and not based on fact. The reality is that the domestic industry will sell well over 200 million gallons of ethanol to coastal markets this year including sales in Alabama, California, Florida, Louisiana, Mississippi, North Carolina, South Carolina, Texas and Virginia.

Domestic ethanol producers sell in a very competitive national market. As with any commodity, changes in price in one part of the country will ripple through the market and effect prices in every sector. Moreover, because the price of ethanol is tied to the cost of petroleum, changes in that highly volatile market will effect the entire ethanol market. In addition, the U.S. ethanol industry is competing with numerous oxygenated fuels and octane enhancers on the market today including MTBE, a petroleum based oxygenated fuel that is marketed by the major oil companies. These marketplace challenges have inspired our efforts as an industry to educate and promote fuel ethanol and are critical to the growth and development of the national ethanol market.

The Renewable Fuels Association has worked at both the federal and state levels to assure the most conducive environment for expanded production and use of fuel ethanol across the country. We have worked with the states on a variety of issues that are indispensible to the viability of the fuel ethanol

industry including pump labeling regulations, pipeline specifications, quality control, and environmental regulations. In order to market in any state ethanol blenders must first meet state blending requirements and follow pump labeling restrictions. We are working in virtually every state in the nation to develop laws and regulations that will enable ethanol blends to be marketed.

A.E. STALEY ETHANOL PRODUCTION FACILITY

A.E. Staley Manufacturing Company is one of the largest corn refiners in the United States. With emphasis on advanced technology, the Company manufacturers and markets a wide range of products including ethanol for use as an octane enhancer in motor fuels.

Our-Loudon, Tennessee facility is the Company's most modern corn processing plant. Others are located at Decatur, Illinois, Lafayette, Indiana and Morrisville, Pennsylvania. Location of the Loudon plant is unusual to the corn wet milling industry which has traditionally located manufacturing facilities close to its raw material source in the Midwest, and therefore, distant from numerous prime markets. At Loudon, the reverse has taken place. The plant is situated in the heart of the nation's growing Sunbelt which gives Staley a strategic location from which to serve expanding ethanol markets in the Southeast and Southwest.

The selection of Loudon as a plant location was enhanced by the availability of both rail and water transportation to the Southeast and Gulf port terminals. The Loudon Plant marks Staley's entry into the field of power alcohol. The alcohol is marketed throughout the Southeast as an octane enhancer for unleaded gasoline.

Ethanol capacity at the Loudon Plant, which grinds more than 100,000 bushels of corn each day, is in excess of 40 million gallons annually. The non-fermentable part of the grain contains most of the non-starch nutritive elements originally present in each kernel of corn and is milled for use in making a variety of food products. Each bushel of corn yields about 2.5 gallons of ethanol plus a variety of valuable coproducts, including distillers dried grains which is used in animal feeds, corn meal which is used in cereals, and carbon dioxide gas which is used to carbonate soft drinks.

Prior to being shipped from Loudon, the 200 proof alcohol is denatured with unleaded gasoline at a 4 to 5 percent level, making it suitable for motor fuel applications. The bi-products are then sold for use in feed markets and the beverage industry.

At Loudon, every step in the corn refining process is carried out with concern for the quality of the finished product, the impact on the environment and the amount of energy required. Our entry into the ethanol market has been highly successful and we expect to continue this partnership of feed and fuel for years to come.

CBI ETHANOL: DEHYDRATION VS. FULL FERMENTATION

In the late 1970's government officials and industry leaders worked together to find alternative energy sources to enhance American energy security in the face of rising energy prices and uncertain supplies. The production of ethanol from renewable feedstocks was considered an exciting new opportunity to improve our national energy security while at the same time establishing new alternative markets for our farmers.

6

The subject of this hearing is ethanol produced or processed in the Caribbean Basin. Several companies have opted to build and operate inexpensive and simple dehydration units have made a decision to import virtually finished ethanol fuel feedstocks from EEC countries and remove the last five percent water content from this product. They have made a decision based on the economics of producing ethanol from sugar cane or other indigenous feedstocks, the costs associated with constructing and operating a modern fuel fermentation facility and the marketplace uncertainties facing ethanol blended fuels.

CBI ethanol dehydration towers exist for only one purpose: to circumvent the United States government tariff on imported fuel ethanol. That tariff was established to offset the economic benefits of the excise tax exemption on ethanol blended fuels. These dehydration towers work only because there is a ready and inexpensive source of hydrous ethanol available in Europe. Without these heavily subsidized feedstocks, dehydration towers in the Caribbean Basin could not operate. The notion that these towers represent a long range market development plan designed to create an indigenous industry in the Caribbean Basin is ludicrous. These towers and the companies that operate them are hooked on heavily subsidized EEC wine alcohol. As one of these companies stated in its "Shareholders Letter", a "capital investment of 42 cents per gallon" is all that is required to build a dehydration only tower compared to at least $2.40 per gallon for a U.S. full fermentation facility.

The fact is that there is very little economic benefit for the Caribbean derived from dehydration only facilities and very grave consequences to both the U.S. treasury in uncollected tariff revenues and the domestic ethanol industry in lost markets and lower prices. Conversely, the only beneficiaries are the few companies that are establishing dehydration facilities and the European countries that are supplying the subsidized ethanol--both of whom gain enormous economic benefit from avoidance of the duty.

Dehydration facilities are a poor option for the Caribbean economy. These plants require little capital to build, employ few workers, and need no locally produced feedstock to make ethanol. As a result, the economic impact on local economies is negligible. A generous estimate is that dehydration only facilities, using non-Caribbean feedstocks, return only 10 cents per gallon of ethanol to local economies. A full-fermentation plant using Caribbean feedstock, on the other hand, would return the equivalent of $1.50 per gallon to local economies. Put another way, dehydration only facilities create only 4 jobs per million gallons of ethanol while a full-fermentation facility, using Caribbean feedstocks, would create more than 400 jobs per million gallons.

Compared to the overall production of ethanol from raw agricultural products, the dehydration process is extremely minor. Under normal commercial circumstances, it would be extremely inefficient for an ethanol producer to have a separate facility for this final task. Congress explicitly designed the CBI to prevent pass through operations in which the work performed is of little economic benefit to the Caribbean and constitutes avoidance of U.S. duties.

The provisions which allow companies to purchase heavily subsidized wine alcohol from Europe, send it to the Caribbean where it is temporarily stored in ethanol dehydration towers for removal of water content, and transship the anhydrous ethanol to the United States exploiting its CBI duty free status have eliminated the economic incentive to establish a sugar-based ethanol industry in the Caribbean Basin. As long as they have access to the subsidized supplies of European wine alcohol, the CBI dehydrators will continue to find ways to maximize imports

rather than seek indigenous Caribbean sources. Thus, the goals of the CBI will never be realized.

ITC AND GAO REPORTS ON FEEDSTOCK REQUIREMENTS

Pursuant to a provision attached to the 1988 Trade Bill, the International Trade Commission (ITC) and the United States General Accounting Office (GAO) delivered Reports to the Congress regarding indigenous feedstock requirements for fuel ethanol imports from the Caribbean and their impact on the U.S. ethanol industry. GAO concluded that "eliminating any (indigenous feedstock) requirement would give CBI ethanol producers an advantage in the market if the CBI companies can readily obtain subsidized European wine alcohol supplies at low prices." ITC noted that "Imported feedstocks, prinicpally from the European Community in the form of wine-based, partially distilled hydrous ethanol, have enhanced the competitiveness of Caribbean Basin producers by lowering overall feedstock costs."

This confirms what the domestic ethanol industry has stated since debate on this issue began nearly four years ago. The single most important factor which makes the CBI circumvention scheme work is the availability of heavily subsidized European wine alcohol which enables CBI trading companies to severely undercut U.S. prices and displace domestically produced ethanol. ITC reports that "The primary feedstock used by the Caribbean ethanol industry to produce the nonindigenous portion of their fuel ethanol for export to the United States has been surplus European wine alcohol, the European "wine lake"." According to ITC, "from 1985 through September 1988, approximately 68 percent of the fuel ethanol imported from the Caribbean Basin countries was produced from surplus wine alcohol."

Moreover, the availability of heavily subsidized European wine alcohol similarly undermines the development of an indigenous ethanol industry in the CBI region which could create substantial employment, capital investment and economic activity throughout the Caribbean. The ITC stated, "it is estimated that increasing the indigenous feedstock level from the mandated 30 percent to a level of 60 percent would have increased employment in the CBI-ethanol industry by aproximately 4,150 workers."

Citing the conflicting objectives inherent in Congress' request for an indigenous feedstock percentage which would preserve the economic viability of the dehydration companies while at the same time 1) discourage pass-through operations, 2) provide meaningful production and employment and 3) not harm the U.S. industry, GAO declined to offer any specific recommendations. Similarly, ITC noted that "a single indigenous feedstock requirement cannot compensate for all of the variations that occur in gasoline prices, European wet ethanol prices, and U.S. net corn costs" and did not make specific recommendations.

Allowing for the possibility that Congress could yet determine that the economic viability of existing Caribbean dehydration facilities was indeed a priority, however, GAO did offer three options for Congressional consideration. Those options include: setting the feedstock requirement at 10-30 percent; eliminating the feedstock requirement altogether, while maintaining the 35%, value-added requirement; and permanently extending the existing grandfather amendments and establishing a 30% content requirement for additional capacity.

The domestic ethanol industry believes that both the ITC and the GAO Reports have mistakenly based their Reports on the following premises: 1) that ethanol dehydration is equivalent to ethanol production and is consistent with the intent of the Congress to stimulate economic development and employment in the region through the maximum utilization of natural resources, and

2) that the Congress must determine a level of imported hydrous alcohol at which these five trading companies can operate and be profitable in the U.S. motor fuels market.

First, there is a profound difference between the production of ethanol from sugar cane feedstocks and the simple processing of ethanol from 190 proof "wet" European wine alcohol. In fact, there is no comparison. To produce ethanol, one needs access to agricultural feedstocks and the ability to ferment sugars into alcohol. It requires substantial capital investment and is highly labor intensive. To process ethanol, all one needs is access to 170 to 190 proof alcohol and an inexpensive, simple dehydration tower. The abundance of heavily subsidized surplus wine alcohol available from the European Community has made ethanol processing through the CBI highly profitable.

Second, perhaps as a result of not differentiating between full fermentation and dehydration, it appears that the Commission and the GAO misunderstood its mission as directed by Congress in Section 1910 (b) of the Trade Bill. The Congress asked only that the ITC determine whether the Section 423 definition of indigenous ethanol will:

1. ensure meaningful production and employment in the region;

2. discourage pass-through operations; and

3. not result in harm to U.S. producers of ethyl alcohol.

Neither the Commission nor GAO was asked to determine a specific level of imported "wet" alcohol at which these companies can operate and be profitable in the U.S. motor fuels market.

While appearing to agree that current ethanol dehydration in the Caribbean does not create meaningful production and employment, not only encourages but is dependent upon the pass-through of European wine alcohol, and could impact the U.S. industry, both Reports offer several policy options which Congress could consider in order to keep the dehydration-only facilities operational. Two critical issues must be considered: 1) Caribbean distilleries using indigenous feedstock such as that in Costa Rica shut down because they could get a better price for the unprocessed raw sugar cane, and 2) the content standards were put in place specifically to discourage pass-through operations. If these pass-through operations subsequently shut down, it should be viewed as an indication that the provisions worked as intended. It must also be considered that these feedstock requirements were agreed to by all parties after several Congressional hearings and with the full understanding that if was the clear intent of the Congress to develop a full fermentation industry in the Caribbean.

During the summer of 1988, three U.S. ethanol producing facilities were forced to shut down due to the uncontrollable drought conditions which drove U.S. grain prices to near record levels. Even with the substantial commitment that this country has made to its domestic ethanol program, there have never been guarantees that ethanol facilities would make a profit and less efficient or poorly managed facilities would not close. If sugar prices in the Caribbean have made ethanol production uneconomic for export purposes in that region, there is no way to justify the utilization of heavily subsidized European wine alcohol in order to assure these companies profitable access to the U.S. market.

Throughout the debate on this important issue, the domestic ethanol industry has steadfastly maintained its wholehearted support for the development of full-production, grass roots ethanol facilities in the Caribbean. As it has in the United

States, an indigenous ethanol industry in the Caribbean would employ thousands of workers, establish new markets for surplus agricultural commodities and enable Caribbean nations to reduce their crippling dependence on imported oil. But such an industry must be based on sound economic and social objectives. The GAO report clearly indicates that dehydration-only ethanol operations are not. According to GAO, they do not create meaningful employment, they encourage the mere pass through of foreign feedstocks, and they will severely impact the domestic industry.

IMPACT OF CBI ETHANOL DEHYDRATION ON U.S. MARKETS

Increases in the supply of ethanol from CBI dehydration facilities threaten to harm the U.S. market in three different ways: 1) by lowering the price in a saturated market because of price competition; 2) by forcing ethanol that would otherwise be sold in a market where tax incentives have been designed to attract domestic production into successively less attractive markets; and 3) by ultimately displacing domestically produced ethanol altogether because it would have to be sold at an unacceptably low price, forcing ethanol plants to close.

All U.S. suppliers of fuel ethanol, including those supplying ethanol produced by the simple dehydration process in the Caribbean, attempt to sell ethanol first in those regions of the country which provide the producer or supplier with the greatest net ethanol revenue. In the ethanol industry, net revenue is determined by the price received for sale in the delivering market, minus the costs of transportation from the ethanol production facility or point of sale. Under the current federal and state tax laws now in place in the United States, and given the current structure of the U.S. motor fuel market, ethanol produced from the CBI will be sent to those states in which it will receive the highest net revenue and where a market already exists.

The RFA estimates that CBI ethanol will first be sent to Memphis, Tennessee. Memphis has an established ethanol market and as the first port along the Mississippi would minimize shipping costs. Because the Tennessee market is already saturated to a point above 95% of the total available market, ethanol delivered from the CBI will directly replace that previously-provided by U.S. producers of fuel ethanol.

While potential dehydrators might argue that they will attempt to sell in yet undeveloped markets, this is highly unlikely. Since product will be delivered in large water barge cargos, it will take the large sale volumes of mature, existing markets to absorb such large shipments. Additionally, these markets already have adequate storage capability to facilitate these types of deliveries.

As CBI dehydrated ethanol captures the Tennessee market, the U.S. product will be withdrawn from Tennessee and attempts will be made to sell it in other states, primarily Nebraska, Illinois and Minnesota. Additional CBI production will have a similar and increasing impact on these markets.

It is important to note that the saturation of profitable markets has already resulted in the domestic industry operating at only 80% of total nameplate capacity as many small producers have idled plants because of the unavailability of profitable markets. Thus, the displacement caused by CBI dehydrated ethanol would result in additional U.S. production capacity being idled. The plant closings would occur among two groups. Small plants under 10 million gallons per year and larger facilities with higher operating costs.

The domestic ethanol industry has taken the position that the development of an indigenous ethanol industry in the Caribbean Basin will provide tremendous economic development opportunities, new alternative market outlets for sugar cane production and employment for tens of thousands of Caribbean farmers and laborers.

Virtually every report and assessment of the economic problems facing the nations of the Caribbean Basin point out the particular concerns with the rising costs of imported energy and falling markets for sugar. Ethanol production in Caribbean Basin nations could achieve the same economic development and employment benefits that ethanol production facilities have generated in the U.S. The production of ethanol in the United States is encouraged by tax incentives designed to make ethanol competitive with gasoline in the marketplace. Ethanol production and blending in Caribbean Basin nations should be encouraged as a means to reduce their costly dependence on imported oil and gasoline, create new markets for sugar cane production, produce a clean burning fuel that will enhance the environment and create thousands of permanent jobs.

The higher gasoline costs in the Caribbean Basin region provide a tremendous incentive to produce an alternative "home grown" fuel for blending and use in Caribbean Basin markets. A plan to develop a Caribbean Basin ethanol production industry designed to use sugar cane as the preferred feedstock could include provisions to take advantage of millions of gallons of inexpensive wine alcohol feedstocks to assist in the development of their industry. It is possible that the CBI countries would decide that such non-CBI feedstocks sources of high proof alcohol for simple dehydration are necessary while they establish their ethanol industry production capacity. A decision to use heavily subsidized wine alcohol for their internal market would provide an important step in the development of an industry capable of producing ethanol from indigenous feedstocks.

The domestic ethanol industry supports the development of an indigenous ethanol industry in the Caribbean Basin. We strongly support the development of an industry capable of consuming surplus agricultural feedstocks in the production of ethanol. We firmly believe that such an industry would provide economic stability, foster economic growth and employment and create new markets for agricultural commodities produced in the region while lessening dependence on imported oil and gasoline. But we cannot support the simple dehydration of European wine passed through to the United States under the guise of Caribbean economic development. It makes a mockery of the CBI and undermines the U.S. ethanol program.

CONCLUSION

My company owns and I am in charge of one of the most modern and efficient ethanol production facilities in the United States. We have made investments, educated consumers, worked with blenders and developed markets for ethanol that did not exist ten years ago. We did all these things because the government made a commitment to the development of this industry as a means of making America more energy secure, providing farmers with a value-added market for surplus grain and cleaning the air. Today, as I struggle to compete in a market in which grain prices constantly fluctuate and petroleum prices climb and fall according to OPEC's whims, we are told that a handful of privileged trading companies that have made no investment in the U.S. market and have no commitment to the future growth of this industry will be allowed to operate simple dehydration facilities using cheap imported feedstock for the sole purpose of reaping huge corporate profits.

As you move from this hearing to work on ethanol language in the final CBI II bill, I encourage you to come to my plant, see the investment we have made in a full fermentation facility and see the dehydration tower that we operate as the very last stage of the ethanol production process. I would encourage you also to go to the Caribbean, see their dehydration tower and look for any other signs of a plant. Finally, go to Europe and see the wine lakes that are waiting to be emptied into U.S. fuel markets. Then ask if this was truly the intent of Congress - to provide additional subsidies to EC wine.

In deliberating this important issue, I hope you will consider not only the original purpose of the CBI but the federal government's commitment to the U.S. ethanol program. If we abandon the requirements that local feedstock be used in order to qualify for duty free status under the CBI and allow increased transshipment of heavily subsidized wine alcohol from Europe, we are severely undermining the U.S. ethanol program that has been the cornerstone for more than $2.5 billion of capital investment that has delivered numerous public policy benefits for the past ten years. I hope that the House Ways and Means Committee will consider these important public policy benefits - energy security, rural development and clean air - and stop the transshipment of wine alcohol through the CBI.

Chairman GIBBONS. All right, Mr. Maloney.

STATEMENT OF WILLIAM MALONEY, GENERAL MANAGER OF JAMAICAN OPERATIONS, TROPICANA INTERNATIONAL, LTD., ACCOMPANIED BY WILLIAM A. KIRK, COUNSEL

Mr. MALONEY. Thank you, Mr. Chairman; members of the Subcommittee on Trade.

My name is William Maloney. I am the general manager of Tropicana International, an ethanol producer in the Caribbean, located in Kingston, Jamaica.

With me today as counsel is Bill Kirk. With your permission, I may have him make a few comments as well, after I present my testimony.

We thank the subcommittee for scheduling these hearings on the requirements under CBI for duty-free importation of ethanol.

Our company in Jamaica, Tropicana International, is a subsidiary of the Tropicana Energy Co. located in Irvine, TX, near Dallas. Tropicana Energy is a blender and marketer of gasolines, with fuel ethanol, with operations in several States. They sell gasohol. They are not wholesalers in ethanol, and the gasoline blends are produced and marketed through their own terminals.

In the early 1980's, we became concerned about having a reliable supply of ethanol for our business. We had experienced supply shortages, and what was essentially rationing by U.S. producers. We examined the CBI Program, and considered the possibility of building an ethanol refinery in Jamaica. Thus, the principal purpose of Tropicana's investment in Jamaica was to ensure a reliable, long-term supply of ethanol.

For this reason, we constructed an ethanol refinery and subsequently invested in a sugar estate and mill. Before Tropicana invested in Jamaica, in June 1984, we submitted our business plan to the United States Customs Service, inclusive of the fact that we would be utilizing European alcohol, seeking a formal ruling as to whether our project was in full compliance with the CBI law.

In September 1984, a letter ruling was issued, and we were advised by U.S. Customs that our project would be in compliance with all the requirements of the law. After we had completed our facility and began production in March 1985, the U.S. industry challenged the Customs ruling and Customs affirmed their original ruling.

We also underwent an extensive audit of all of our costs by the U.S. Customs Service, and were found totally in compliance with the 35-percent value-added criteria.

In 1985, when oil prices were high, Tropicana did make reasonable profits. However, all these profits have been reinvested in Jamaica, and no dividends have been made. A portion of the profits were reinvested in expanding the capabilities of our refinery, facilities, and the balance were invested in the development of the 6,000-acre Duck and Field sugar estate and factory in eastern Jamaica.

Since 1986, we have operated at a loss or near breakeven.

The primary purpose for our investment in the sugar estate was to assure that we would have some control over the availability of ethanol feedstocks in the future .

Unfortunately, since the inception of the CBI, the question of ethanol has been a matter of misunderstanding, misinformation, and deliberate extortion.

As a consequence, jobs in the region have been lost; ethanol projects such as ours and projects of other private investors and CBI governments have been needlessly jeopardized, and the commitment of the U.S. Government to fairness and to the CBI Program has been called into question.

We welcome this opportunity to set the record straight on the nature of CBI ethanol production.

The 1988 Trade Act directed the General Accounting Office and the International Trade Commission to study the Caribbean ethanol industry, and its effects on U.S. producers and determine whether the local feedstock rules enacted in 1986 are economically feasible; would contribute to regional economic development and are needed to protect U.S. producers.

Both reports have been completed and find that the local feedstock rule enacted in 1986 is economically unfeasible. GAO recommended as one option for change that we return to the original CBI law under which we made our investment.

We wholeheartedly endorse this finding, and GAO's recommendation.

To date, we have invested $12 million United States dollars in Jamaica. We are the largest United States employer in Jamaica, and we provide $10 million annually in badly needed foreign exchange to Jamaica.

If we are permitted to operate under the original CBI requirements, just as all other industries would operate, I believe it will succeed as a business enterprise, will provide substantial economic benefits to Jamaica, and will continue to fulfill the good intentions of the CBI.

If existing law becomes effective in 1990, we will be unable to continue our operation. The jobs that we created will be lost. Jamaica will lose foreign exchange earnings, and our investment will be rendered worthless.

Now, since I've had the benefit of listening to some discussions earlier, there are a couple of other points that I just would respond to quickly.

One of them is that before the ITC hearings, the Renewable Fuels Association came and testified that a full fermentation Caribbean industry was simply not feasible.

But yet you hear them say that we really want jobs and we want a full fermentation industry that will create jobs.

Second, for the last 7 months, we have been operating under original law, the 35 percent value-added; and over that period of time, less than 10 million gallons of ethanol have come from the Caribbean to the United States. And virtually all that production has come from us. The other producers have not been able to source feedstocks out of Europe. There is a mythical European wine lake. It's just not available in the quantities that others would make you believe.

All the CBI governments, as recently as last summer, wrote this committee, and told this committee that the ethanol industry was

important to them. And when they said "ethanol industry," they meant ethanol dehydration, full fermentation—the entire industry.

If they feel it's valuable, why would Congress turn around and say the governments don't think it has value?

Third, they will introduce to you, and you have received them previously, letters from the All-island Jamaica Cane Farmers Association, fully supporting our position on ethanol, as well as from the two industrial trade unions in Jamaica, in support of our position.

I also want to point out that never in the history of Congress has the duty-free status for any commodity ever been removed because that commodity, in the opinion of Congress, did not create enough jobs.

I would like to turn it over to Mr. Kirk, if I could, for a moment, to say a few words.

[The statement of Mr. Maloney follows:]

STATEMENT OF WILLIAM MALONEY
ON BEHALF OF

TROPICANA INTERNATIONAL LTD.
KINGSTON, JAMAICA

Mr. Chairman, Members of the Subcommittee on Trade, my name is William Maloney. I am the General Manager of Tropicana International, an ethanol producer in the Caribbean, located in Kingston, Jamaica.

We thank the Subcommittee for scheduling these hearings on the requirements under the Caribbean Economic Recovery Act (popularly known as the Caribbean Basin Initiative or CBI) for duty-free importation of ethanol.

Unfortunately, since the inception of the CBI the question of ethanol has been a matter of misunderstanding, misinformation and deliberate distortion. As a consequence, jobs in the region have been lost, ethanol projects, such as ours and projects of CBI governments, have been needlessly jeopardized, and the committment of the U.S. government to fairness and to the CBI program has been called into question. We welcome this opportunity to "set the record straight" on the nature of CBI ethanol production.

As you know, the requirements for duty-free treatment for CBI produced ethanol were substantially and unreasonably altered by the Tax Reform Act of 1986. By rapidly increasing percentages, indigenous feedstock or raw materials requirements were mandated in addition to the basic CBI 35 percent "value added" -- in 1987 at least 30 percent local feedstock was required; 60 percent in 1988 and at least 75 percent in 1989 and thereafter.

These restrictive rules were disingenuously promoted by representatives of the domestic ethanol industry to protect them from competition and allegedly to aid the Caribbean region. CBI ethanol has had little impact on domestic producers and far from benefiting the Caribbean, those feedstock rules had the exact opposite effect. Because of the adverse consequences of these rules on CBI producers and workers, the 1988 Trade Act temporarily suspended the feedstock rules through calendar year 1989 for five CBI ethanol projects and imposed duty-free production limits of 20 million gallons per facility. Only three of the five projects are operational.

The Trade Act also directed the General Accounting Office (GAO) and the International Trade Commission (ITC) to study the Caribbean ethanol industry and its effects on U.S. producers and determine whether the local feedstock rules enacted in 1986 are economically feasible, would contribute to regional economic development, and are needed to protect U.S. producers. If the requirements were found not to be feasible the agencies were to recommend modifications that (1) would insure meaningful production and employment, (2) discourage mere pass-through operations and (3) not result in harm to U.S. producers.

Both reports have been completed and recommend that the local feedstock rule enacted in 1986 be changed because it is economically unfeasible. We wholeheartedly endorse this finding and recommendation. Specifically, GAO and ITC found:

-The current law feedstock requirement is not economically feasible nor will it permit CBI producers to be competitive and contribute to the economic development of CBI countries.

-The indigenous feedstock requirement significally (and adversely) raises the cost of production for CBI ethanol producers.

-The CBI ethanol industry is comprised of both ethanol dehydration facilities and sugar production and fermentation facilities and significant capital investments have been made.

-Employment by CBI ethanol producers in the sugar industry is substantial -- over 3,000 direct jobs in Jamaica and Costa Rica (the principal producers), approximately 3,500 seasonal workers and about 100 permanent jobs in dehydration plants.

-CBI imports are small -- about 3 percent in 1987 of an 800 million gallon U.S. market -- with little impact on U.S. producers.

-There is a large surplus of wine in Europe but the actual amount that will realistically be available to CBI producers is limited.

-CBI producers have used European wine as a feedstock when indigenous feedstocks have been unavailable or too costly.

-The policy goals implied by the Trade Act are in conflict and involve trade offs.

Mr. Chairman, Tropicana cooperated fully with GAO and ITC investigators. We made proprietary information available for study and inspection. GAO and ITC personnel made on-site visits to our facilities in Jamiaica and we fully responded to their requests for information. We also participated in the formal hearing held by the ITC.

Before commenting in detail on the GAO and ITC findings, it will be helpful to review how we have reached this point today. It is important to note that the domestic ethanol industry opposed the temporary suspenaion of the 1986 feedstock rule and the study mandated by the Trade Act. It was argued that "we will displace up to 10 percent of the 1988 corn crop ... eliminate a market for 250,000 tons of U.S. coal ... lose 500 jobs in American's ethanol industry, 3,000 jobs indirectly related, and will dump 200 million gallons of highly subsidized European wine alcohol into the American market ... $120 million in tarriff revenue [will be lost]". (Congressional Record)

Mr. Chairman, there is absolutely no evidence to substantiate these claims. In fact, data on the level of CBI ethanol production and imports since enactment of the Trade Act shows how absurd are the claims.

Since enactment of the temporary trade act provision to date, less than 10 million gallons of CBI ethanol have been exported. In fact since the inception of the CBI in 1983, CBI exports to the U.S. have never exceeded 29 million gallons annually. Only three CBI producers have been able to operate -- at low levels. Two other facilities covered by the provision remain under construction, their completion delayed because of continuing uncertainty on this matter. Further, GAO found the current effective, combined production capacity if all plants covered were able to produce at about 88 million gallons a year. As GAO correctly states, there is a significant distiction between design or nameplate capacity and actual effective production capacity.

Mr. Chairman, the gross misstatements and unsubstantiated claims of the domestic industry during the debate on the Trade bill unfortunately and sadly illustrate the domestic industry's basic approach to this matter. Moreover, the same tactic of misstatement and distortion has also been directed at our company. Our company in Jamaica, Tropicana International, is a subsidiary of the Tropicana Energy Companies located in Irving, Texas near Dallas. Tropicana Energy is a blender and marketer of gasolines with fuel ethanol with operations in several states. We are not wholesalers of ethanol. The gasoline blends are produced and marketed through our own terminals.

Our Jamaican operations, as verified by GAO and ITC, consist of an ethanol plant in Kingston which has a design capacity of 28 million gallons and a 6,000 acre sugar estate previously closed by the Jamaican Government and a sugar factory in St. Thomas Parish, Jamaica. The investment in the ethanol plant was approximately $6 million. The company has invested an additional $6 million in restoring the sugar fields and mills. However, the mill was directly on the path of Hurrican Gilbert and suffered extensive structural damage as well as damage to crops. Nonetheless we have rebuilt and the estate has begun harvesting this year's crop. As GAO and ITC found, our company employs nearly 1,000 workers. We directly support another 1,000 private cane farmers. Also, our dehydration plant employs 35 workers and buys materials and utilities from the local market. The ethanol plant has used European surplus wine as well as feedstock from CBI countries. The plant earns $10 million per year in badly needed foreign exchange for the Jamaican Government. Thus, Mr. Chairman the facts about Tropicana are far different from the statements asserted by representatives of the domestic ethanol industry.

There are three principal purposes for Tropicana's backward integration into ethanol and sugar production in Jamaica. First, was the CBI program itself, and the underlying policy objectives of Congress. Second, was the favorable local business climate. Third, and most critically was our need for a reliable ethanol supply for Tropicana's U.S. markets particularly in the South and West.

As GAO and ITC reported, the U.S. ethanol industry is highly concentrated. There are very few domestic suppliers. Specifically, in its report GAO found that one producer accounts for over 66 percent of supplies. Three other smaller companies account for over 20 percent. Thus, four companies account for nearly 90 percent of U.S. production.

We believe the near monopoly control by a handful of suppliers is a serious impediment to the future growth and expansion of the U.S. ethanol market. Often these companies are unable to meet demand or to guarantee product availability on a long-term basis. Many times they refuse new customers and essentially ration supplies. This occurs most often when they concentrate on producing corn sweetners (HFCs) for the candy or soft drink markets. In fact, since 1987, one large producer has simply refused to sell to our U.S. company we believe because of our efforts to encourage new domestic supplies and because of our own backward integration into ethanol production. Prior to this cut-off, we purchased more than 75 million gallons annually from this firm. Tropicana is presently selling nearly 200 million fewer gallons of gasohol (ethanol blended gasoline) annually than it did previously because ethanol supplies are not available.

Mr. Chairman, Tropicana began its planning for ethanol production in Jamaica in 1983. Our strategy has been on a phased basis. The first phase was the construction of a dehydration and distillation facility. This was accomplished in 1984 and the plant became operational in early 1985. It is somewhat ironic to note in 1985 the U.S. Commerce Department nominated Tropicana for an award for this plant. We were touted as an excellent example of U.S. private sector investment under the CBI. The Jamaican Prime Minister Edward Seaga opened the facility and he was joined by representatives of the U.S. government in praising the project.

The second phase, backward integration to the production of ethanol from sugar cane, is proceeding but has been more difficult. As we mentioned previously and as mentioned by GAO and ITC, Tropicana has a acquired and reopened a sugar estate and mill, Duckenfield, in Eastern Jamaica.

Negotiations with the Jamaican Government to acquire sugarlands, a sugar mill and a fermentation facility dedicated to ethanol production began in September 1984. In 1985, a tentative agreement for long-term lease of a 13,000 acre sugar estate was aborted by the Government for other uses. Subsequently, negotiations for the 6,000 acre Duckenfield Estate were completed in July 1986. Several million dollars has been invested to refurbish and replant cane and to repair the estate sugar mill. Again we directly employ nearly 1,000 people at the estate and support many small farmers who use the estate facilities to grind their cane. Without Tropicana, the estate and sugar mill would have been closed and the livelihood of these small-scale cane farmers would be threatened. These farmers would have no place to process their sugar cane.

Mr. Chairman, at the time we made our investment in Jamaica world crude oil prices were double what they are today. The price of gasoline was substantially higher and the price of sugar was below 5 cents per pound. In 1986 world sugar prices began an upward trend that has continued to the present and world oil prices collapsed. In short the economics for converting CBI sugar and molasses was far more favorable in 1984-1985 than under current and prospective market conditions.

Recently there has been much discussion with regards to alleged profitability of ethanol dehydration. I wish to set the record straight. In 1985, when oil prices were high Tropicana did make reasonable profits. However, all these profits have been reinvested in Jamaica and no dividends have been repatriated. These profits were reinvested in expanding

the capabilities of our production facilities and in the development of the Duckenfield sugar estate and factory. Since 1986 we have operated at a loss or near break even.

Notwithstanding these changing and negative market conditions, Tropicana is committed to its Jamaican operations -- that is, if permitted to do so by the Congress. Tropicana is committed to using local feedstock when available and when economically feasible to do so. The Tropicana companies also have a long-standing committment to the growth and health of the U.S. ethanol market. We contributed to its growth in a number of ways, for example, market development in historically underserved areas as well as innovative techniques of blending which have been adopted by others. Moreover, we supported the development of Texas's only ethanol production plant, Ethtec. Property in Euless, Texas owned by Tropicana was made available for the plant and we contracted to purchase 17 million gallons annually. Unfortunately, Ethtec ceased production in the summer of 1988 due to the sharp, drought-induced grain price increases which made ethanol production prohibitive.

Mr. Chairman, one of the most important findings of the ITC and GAO is that the current law feedstock requirement is not economically feasible. Three options were presented by GAO to the Congress -- depending on Congressional priorities. Briefly, those options are: (1) set a feedstock requirement of no higher than 30 percent to be gradually phased in over a period of years in addition to the basic CBI 35 percent value-added rule, (2) returning to the original CBI law which requires all products to meet the basic 35 percent value with no special ethanol feedstock rule or (3) apply the basic CBI value-added rule with no feedstock requirement for all companies currently "grandfathered" under the 1988 Trade Act for the first 20 million gallons of production, then mandate a feedstock requirement for additional production and for any new plants.

Based on all the evidence developed by GAO and ITC we believe that the second option -- a return to the original CBI law with no feedstock requirement -- is the most appropriate. It is consistent with the original intent of the Caribbean Basin Economic Recovery Act. It is the option that most assures that all the benefits currently accruing to the Caribbean may be maintained. It is the law under which we made our investments. It would reduce uncertainty and restore confidence that the Congress will not change the rules "in the middle of the game" -- especially where there is no adverse impact on a domestic industry. It would eliminate the foreign policy "flip flop" that encourages investment on one hand and takes away successful projects with the other.

The GAO and ITC findings also place into perspective the matter of European wine. The European Community (EC) and its member nations have large quantities of surplus wine alcohol. European wine has been used by Tropicana and other CBI producers when indigenous raw materials have been unavailable or too costly. However, GAO found that the amount of European alcohol stocks available to CBI producers is uncertain. Both the amount and the quality of the alcohol is doubtful. Moreover, GAO found that it is questionable whether CBI producers will be able to acquire all or even most of the stocks that could sustain the current CBI effective production capacity of about 88 million gallons.

Information developed by the ITC is equally telling. During the period 1985-88, on average only approximately 30 million gallons of surplus EC wine alcohol were imported to the CBI region each year or a total of 90 million gallons. This would produce approximately 25 million gallons of ethanol annually. The fact that less than 10 million gallons has been imported in the seven months since enactment of the 1988 Trade Bill provision is compelling evidence that concerns about the so-called "European wine lake" are unwarranted.

Finally, Mr. Chairman the GAO and ITC reports provide much needed clarity on the nature of azeotropic distillation. This process is not a simple "dewatering" or a "mere pass-through" operation as euphemistically labelled by the domestic industry. It is an extremely complex chemical process. Both reports note that the U.S. Customs Service ruled on this issue in 1985 and expressly affirmed that the process creates a new or different article of commerce and involves substantial transformation. Subsequently, after a petition for review filed on behalf of the domestic industry the Customs Services reaffirmed its orginal ruling stating the following: (1) Hydrous and anhydrous alcohol are different articles of commerce. (2) Azeotropic distillation is more than a simple boiling and cooling procedure. The process involves complex equipment, sensitive instruments and trained personnel. (3) There has been ample capital investment. (4) The technical skill required of the workers to operate and monitor the system is of sufficient complexity to take the operation out of the simple combining, packaging or mere dilution catagorization. (5) The conversion of hydrous alcohol to anhydrous is a significant step in the manufacture of ethanol. A copy of the complete ruling is attached to my testimony.

In closing, Mr. Chairman let me reiterate Tropicana's endorsement of the data and findings developed by the GAO and ITC. Their reports are thorough and comprehensive.

Again, Tropicana believes of the three options suggested by GAO for resolution of this matter that GAO's second option -- a return to the original CBI law -- is the most appropriate.

We offer to you the following guidelines for analyzing this matter. In enacting the CBI program, Congress invited American firms such as Tropicana to invest in the region with reliance that the rules and benefits under the program would remain in place for 12 years. The ultimate success of the program depends greatly upon its credibility and reliability in the eyes of the private sector. Strong weight should be given to the factor of reliance, and particularly to actual reliance by existing investors. Thus, we believe modifications to the CBI should not be taken lightly as unfortunately has been the case with ethanol.

It has been also argued by the domestic industry that CBI nations would be better served by a feedstock requirement. We believe decisions to modify the law should be made with thorough consultation with the affected Caribbean nations. In the case of ethanol, CBI nations have spoken clearly. In letters to the Congress and to this committee, in meetings with U.S. officials and in conversation with the GAO and ITC, CBI governments have repeatedly expressed their strong support for the ethanol investments in their countries. Similar statements of support have been forthcoming from regional labor organizations and agricultural groups.

Mr. Chairman, as you know the CBI "rules of origin", "substantial transformation rule" and "value-added" tests are straightforward and are designed to ensure compliance with the law. We have no quarrel with these standards. Clearly the application of these standards at some point becomes a technical question. Under the law, the authority to decide such technical questions is given to the U.S. Customs Service. Several times the Customs Service has considered this issue of ethanol azeotropic distillation and each time has concluded that the process meets the standards for substantial transformation. The findings of agencies responsible for these technical questions should be respected and not circumvented.

In addition to the "rules of origin" requirements established by the CBI, Congress also created an administrative process for domestic industries to receive relief if there is a showing of harm or hardship. In such instances the President has the authority to end duty-free status of the product in question even though all the requirements of the law are being met.

Even though the domestic ethanol industry claims it is being harmed by CBI producers they have never availed themselves of this procedure -- because the facts are otherwise. GAO and ITC found little or no impact on U.S. producers by the CBI. Thus, again we believe a return to the original CBI law is warranted in this case.

Mr. KIRK. Mr. Chairman, just very briefly. Earlier Congressman Russo asked some questions about the spirit and the intent of the law and what it said specifically about ethanol. He's probably correct. It did not have any findings specifically on ethanol.

But I would ask the staff to refer you to certain sections of the CBERA, the Caribbean Basin Economic Recovery Act—I believe it is section 219, which emphasizes that the act is going to assure fair and reasonable market access to the United States market, if you link the value-added requirement and the substantial transformation rule enacted in that statute.

So, I think perhaps that is some guide as to what the intent of the Congress was.

Second, and very quickly, part of the Renewable Fuels Association testimony talks about the question of promises versus actual experience.

And I guess we really don't have time to go into the complete history today, but, as Mr. Maloney said, part of our problem here has been misinformation.

If we go back to the date of this temporary compromise, this temporary moment that brought us here today in the 1980 act, it's very interesting to see what the debate on that particular proposal focused on.

And, remember, we are talking about the proposal that was going to be in effect for about 15 months. There were caps on production and so forth.

If I recall that debate, we were told that if that went into law, that 10 percent of the U.S. corn crop was going to be displaced, 250 million tons of coal was going to be displaced, that ethanol was going to be displaced, that 500 direct jobs in the ethanol industry, U.S. ethanol industry would be displaced, another 3,000 indirect jobs would be displaced, and that the U.S. Treasury was going to lose $120 million in lost tariff revenue.

I submit to you, Mr. Chairman, that's a great example of the problem we have here. You people are well-intentioned on both sides. However, there's too much hyperbole, and too much misstatement information. Therefore, we have welcomed the GAO and the ITC reports. We think they provide a factual record from which you can judge and make your determination in this matter.

Thank you.

Chairman GIBBONS. Mr. Shepard, Mr. Maloney, I introduced the first Caribbean Basin bill and it went to the Senate where it died. I introduced the second bill; it went to the Senate and became law. I chaired all of the meetings and attended all the hearings on the Caribbean Basin Initiative, and I never heard the word "ethanol" until somebody came in and said, oh, there's a scam being pulled; there's fraud. Critics said that people in the Treasury have issued a license to people to produce ethanol in the Caribbean, and their plants don't meet the requirements on value added and substantial transformation. That's why I had a hearing on this subject—because I'd never heard of ethanol, and when anybody says it's a scam, my ears immediately perk up.

We had the hearing and there was really no evidence that there was any fraud or any scam or anything else. And we didn't drop the matter, for the lobbying in Congress didn't stop.

Now, that's the first I heard of it. That was some time after both the bills were passed. One of the long debates we had in Congress during the first bill and the second bill on CBI, was what kind of domestic content will a product have to have before it can be a product of the Caribbean?

Some people wanted it very high. Some people wanted it very low. There were arguments that if we put it very low, it was just going to be a passthrough operation. There were arguments that if it were going to be very high, with the Caribbean being such a poor area, it will never get off the ground.

So, we tried 30 percent; we tried 40 percent. We finally ended up with 35 percent. The law says very clearly that any product is a product of the Caribbean as long as it has 35-percent Caribbean value-added.

That's all the law requires—at least for every other product down in the Caribbean except ethanol. I'm not going into the 1986 act. It's got a lot of controversy surrounding it. You know, I've got a whole lot of people in Florida who are upset with the Caribbean initiative and with me over the Caribbean initiative; but I haven't come in here and said just because I have trouble in Florida over the issue of Caribbean domestic content that I think we ought to change the requirement. I haven't done that.

And I don't think anybody else ought to do that really. I just don't see where you stand on the thing.

Mr. Shepard, you are a fine gentleman, and I admire you, and I respect you, but on the history of the matter, you are just dead wrong. I was here. I am the history of it. [Laughter.]

Mr. VAUGHN. Mr. Chairman, it's been a long history on this issue. As I sat through the last couple of hours and listened to much of the revisionists in perspective on what happened in late 1985, not 1986, that very late meeting with Mr. Anthony, you conducted a hearing in February of 1986; there was an oversight committee hearing in early 1986; there was a full committee vote on this issue. I don't believe anyone late in the evening decided this issue; it was decided in the full and open debate of the committee.

Chairman GIBBONS. There have been many subcommittee hearings on this particular issue.

Mr. VAUGHN. We had two separate panel discussions, not a separate hearing. You are absolutely correct, but we did meet and discuss this.

But I would like to try and react to something. You said it twice now, that many people in Florida would come to you, or would be anxious to make certain that not a simple transformation of a process, a transshipment of a product might not occur in the Caribbean Basin.

You resolved that possibility in the CBERA with orange juice, for example. A South American company couldn't bring in a concentrated orange juice product to, let's say, Jamaica, and add Jamaican water—fine water, I would admit—but add Jamaican water to it, and bring it to the United States as Jamaican orange juice.

We met with you in early, in mid-1985 to discuss this problem with you and we said that what was happening was just the reverse: wine alcohol, a gallon with a little bit less than what's in

this cup is coming in to the water, is being brought from the European community in to the CBI for water removal.

That's ethanol dehydration.

Chairman GIBBONS. Didn't the court rule against you?

Mr. VAUGHN. The Court ruling that is being referred to here is with regard specifically to substantial transformation, and the court, after the Customs Service ruling, looked at this.

The Customs Service was dealing with a set of facts that turned essentially one article of commerce, beverage-grade alcohol, into a second grade of commerce, pure grade alcohol.

What the ITC and GAO reports pointed out quite clearly was that the average alcohol content from Europe being sold to the Caribbean basin is not a beverage-grade alcohol product. It's averaged 186-proof alcohol. That's 7 percent water and alcohol. That water's removed in the Caribbean Basin.

Chairman GIBBONS. You had your day in court, didn't you?

Mr. VAUGHN. Mr. Russo referred to this body as the "court of appeals," and what we did was come into the——

Chairman GIBBONS. You had your day in court, didn't you?

Mr. VAUGHN. Yes, sir. On the substantial transformation issue, that's correct.

Chairman GIBBONS. Under the law?

Is that correct?

Mr. VAUGHN. On the issue of substantial transformation.

Chairman GIBBONS. And the Treasury was sustained in their position that it met the 35-percent transformation requirement, isn't that correct?

Mr. VAUGHN. I wasn't a party to the court proceeding, but I assume you are correct, on the 35 percent value-added.

There's a point to be made with this with regard to the wine alcohol, and something that has been coming up that Mr. Kirk just mentioned, and I assume that we are having something of a free flowing discussion here, that over the last couple of years there has been a tremendous amount of debate and a very anxious debate over this issue.

Now, the numbers Mr. Kirk referred to are indeed accurate when one assesses the potential for 200 million gallons to come into this country.

Last year, and put into the context of the trade bill, the Congress allowed for the opportunity of 200 million gallons to come in. The fact that 200 didn't come in, quite frankly, is regarded by this industry as a success.

As Mr. Shepard pointed out, the 3 percent is all that came in over the 1987. The fact is that 200 million gallons might have been able to come in over that period of time.

Chairman GIBBONS. The situation is that for ethanol there is a whole different set of rules than there is for every other product coming into the United States from the Caribbean, is that right?

Mr. VAUGHN. Correct.

You couldn't have said it better. You are absolutely correct.

Chairman GIBBONS. While you were still lobbying, you were able to get an Act of Congress to change that.

Mr. VAUGHN. It's extremely important to point out that ethanol becomes a little more unique than this committee would have pointed out even this morning.

Ethanol coming out of the Caribbean Basin not only enjoys duty-free access to the United States market, access to the many market activities that are currently developed. Mr. Shepard's company paid for that marketing activity in the United States, but also, most importantly enjoys a very unique incentive. It is the only product out of the Caribbean Basin that currently enjoys any sort of domestic marketing incentive. It is the only commodity out of the Caribbean Basin that gains access to that incentive.

Not only do they get duty-free access that the Congress put in place that duty to offset the benefits of that incentive in the U.S. market. It doesn't protect the U.S. industry. It protects the U.S. Treasury through the——

Chairman GIBBONS. The other middle-of-the-night operation that I'll tell you about, if you want to recall some dirty history.

I happen to have been present on that night, too. And that was a question of when we tried to have a conference committee report. Senator Dole brought up this whole question of taxing alcohol coming into the United States—I'm not going into all of that, but we were pressured into having to accept his amendment or we wouldn't have gotten any kind of agreement on the rest of the conference report. He had that right; he had that authority, and he had that power. But, you know, we gave into him.

Mr. VAUGHN. But the domestic ethanol industry——

Chairman GIBBONS. For an industry that receives as much Federal subsidy as you all do, I think it ill-behooves you to complain about anybody else's little subsidy.

I want to tell you when your subsidy comes up for review, you can't count on my vote.

Mr. VAUGHN. It's something that has garnered a tremendous amount of attention. Maybe the most recent and effective piece of work that was done on the incentive itself, which is quite frankly the reason why the domestic industry and the Caribbean Basin producers are here today. That marketing incentive is, in fact, the bulwark of this industry.

Vice President Bush's 1987 Alcohol Fuels Task Force reported that the domestic ethanol industry's marketing incentive is equal, certainly offset, more than likely the Government makes $2 for every $1 it loses. This is an official document of the administration, and Mr. Bush is updating that report at the present time.

Our feeling is that that marketing incentive has been extremely effective, and, in fact, pays for itself in terms of lower Federal farm program costs. And that's one of the reasons why the domestic ethanol industry and the Caribbean producers actually share a common bond with this industry.

We support, fully support the development of an indigenous industry in the Caribbean Basin. In fact, El Salvador ought to be here today to talk about their very effective ethanol production program designed to produce ethanol from sugarcane for use in El Salvador, a very efficient and very highly regarded program.

Mr. KIRK. Mr. Vaughn mentioned El Salvador—I would simply add that last year, as Mr. Vaughn has told you, the ambassadors

representing all the Caribbean countries covered by the CBI wrote to this committee and told them they fully supported the efforts to retain the ethanol industry including its dehydration components and the full fermentation component.

So, I think the Caribbean has spoken with one voice on this issue.

Mr. VAUGHN. Bill, I think you are absolutely right. I've read your letter and thought the statement coming out of the ambassadors from the Caribbean Basin was indeed very impressive, and we wouldn't change a word in it other than the fact that the ultimate objective is to move from dehydration and into full fermentation.

I think what the Caribbean ambassadors, and more importantly, the Caribbean people see, is the potential for jobs for economic development for a greatly enhanced energy security that will accrue from the development of an indigenous ethanol industry, not a passthrough industry. That's what we're trying to get away from and onto. And that's what the objective of 30, 60, and 75 was all about.

Two of the three negotiators that sat in George Weiss' office to work out those numbers are here in the room. The third, Mr. Vin, is out on the west coast, I assume.

But we worked on an agreement that would move the dehydrators away from dehydration and into full fermentation, which I think is the bulwark again of the support for indigenous industry in the Caribbean Basin.

Mr. MALONEY. But, just let me interject, that does contradict your testimony at ITC where you had said that it is not economically feasible for them to produce an indigenous, totally full fermentation industry and export to the United States.

Mr. VAUGHN. I wish that I had seen you there at the hearing, but our statement was, in fact, designed to point out that under current economic conditions—it is important to point out that the price of sugar has quintupled since this debate stated, that it is not economically feasible today, in our estimation, to produce ethanol from sugarcane, for one very simple reason: there's a tremendous market opportunity and demand for sugarcane in the form of sugar today, and they choose to make sugarcane into—grow sugar cane and produce it into sugar versus processing it into ethanol.

More importantly, and I think extremely important to understand with our testimony, and the reason we are still supportive today, there's no other ethanol industry in the world that has practiced something called backward integration, which is essentially building the tower, profiting off the ethanol, and making the bucks.

Every other industry in the world—El Salvador, Argentina, Brazil, United States, have practiced forward integration, which requires front-end investment, costly market development, developing byproduct markets, expanding that market, and using domestic subsidies, quite frankly, to get that done.

We would encourage the domestic ethanol industry in the Caribbean Basin to follow the world lead on this issue.

Mr. MALONEY. Mr. Chairman, if I could just add—I'll submit for the record a copy of the United States Customs Service ruling that determined that the process, and the manufacturing process we do in Jamaica, is a significant manufacturing process. It creates a new

and different article of commerce, and constitutes substantial transformation.

Mr. JENKINS [presiding]. Without objection.

[The following was subsequently received:]

DEPARTMENT OF THE TREASURY

Customs Service

19 CFR Part 175

Receipt of Domestic Interested Party Petition Concerning Tariff Classification of Certain Fuel Grade Ethanol

AGENCY: U.S. Customs Service, Department of the Treasury.

ACTION: Notice of receipt of domestic interested party petition; solicitation of comments.

SUMMARY: Customs has received a petition submitted on behalf of several domestic interested parties with respect to Customs determination that certain fuel grade ethanol imported from several Caribbean Basin countries may qualify for duty-free entry under the Caribbean Basin Economic Recovery Act (CBERA). The petitioners contend that the ethanol is currently incorrectly classified under the CBERA as being eligible for duty-free entry into the U.S. They believe that the beverage grade ethanol transformed to fuel grade ethanol in the Caribbean Basin countries is not subjected to a "substantial manufacturing process" and does not produce a "new or different article of commerce". Therefore, they believe the duty prescribed for ethanol in the tariff schedules should be collected. This document invites comments addressing the correctness of the current classification.

DATE: Comments must be received on or before June 10, 1985.

ADDRESS: Comments (preferably in triplicate) may be submitted to the Commissioner of Customs, Attention: Regulations Control Branch, Room 2426, 1301 Constitution Avenue, NW., Washington, D.C. 20229 (202–566–8237).

FOR FURTHER INFORMATION CONTACT: Harold Singer, Classification and Value Division, U.S. Customs Service, 1301 Constitution Avenue, NW., Washington, D.C. 20229 (202–566–2938).

SUPPLEMENTARY INFORMATION:

Background

Pursuant to section 516, Tariff Act of 1930, as amended (19 U.S.C. 1516), a domestic interested party petition has been filed with respect to Customs determination that certain fuel grade ethanol imported from several Caribbean Basin countries may qualify for duty-free entry under the Caribbean Basin Economic Recovery Act (CBERA; 19 U.S.C. 2701). The product at issue, ethyl alcohol (ethanol) imported for use as a fuel, is classified under item 901.50, Tariff Schedules of the United States (TSUS; 19 U.S.C. 1202), at a rate of duty of 60¢ per gallon. (This 60¢ per gallon duty is in addition to a 3% ad valorem duty on ethanol for nonbeverage purposes from item 427.88, TSUS). However, some ethanol may enter the U.S. free of duty since Customs has ruled that the transformation of beverage grade ethanol from a non-beneficiary country to motor fuel ethanol in a beneficiary country through azeotropic distillation is sufficient to make the motor fuel ethanol a product of the beneficiary country for purposes of the CBERA.

The petitioners contend that fuel grade ethanol is not a new or different article of commerce from beverage grade ethanol as the only significant difference in the composition of the two is their water content. It is argued that azeotropic distillation is not a substantial manufacturing process. The azeotropic method of distillation involves adding benzene or some other chemical to 190 proof ethanol and then heating the mixture so that the benzene will vaporize and carry away most or all of the water in the mixture. This results in ethanol of a higher proof.

The possibility that importers will import ethanol free of duty is the result of two previous Customs ruling letters. In Customs letter CLA–2 CO:R:CV:V, 553209 HS, September 12, 1984, it was stated that an article is substantially transformed for tariff and related purposes when, as a result of a substantial manufacturing or processing operation, a new or different article of commerce emerges having a name, character, or use which is distinct from the article or material from which it is transformed. Applying this definition, it was determined that azeotropic distillation is a substantial processing operation and fuel grade ethanol was a different product from beverage grade ethanol.

In Customs letter CLA–2 CO:R:CV:VS, 071693 TL, January 3, 1984, it was determined that General Headnote 3(a), TSUS, would afford duty-free entry to 190+ proof alcohol that had been produced from 180–190 proof alcohol after azeotropic distillation performed in the U.S. Virgin Islands.

Comments

Pursuant to § 175.21(a), Customs Regulations (19 CFR 175.21(a)), before making a determination on this matter, Customs invites written comments from interested parties on the classification issue.

The domestic interested party petition, as well as all comments received in response to this notice, will be available for public inspection in accordance with the Freedom of Information Act (5 U.S.C. 552), § 1.6, Treasury Department Regulations (31 CFR 1.6), and § 103.11(b), Customs Regulations (19 CFR 103.11(b)), between the hours of 9:00 a.m. and 4:30 p.m. on normal business days, at the Regulations Control Branch, Headquarters, U.S. Customs Service, 1301 Constitution Avenue, NW., Room 2426, Washington, D.C. 20229.

Authority

This notice is published in accordance with § 175.21(a), Customs Regulations (19 CFR 175.21(a)).

Drafting Information

The principal author of this document was John E. Doyle, Regulations Control Branch, U.S. Customs Service. However, personnel from other Customs offices participated in its development.

William von Raab,
Commissioner of Customs.

Approved April 2, 1985.

John M. Walker, Jr.,
Assistant Secretary of the Treasury.

[FR Doc. 85–8709 Filed 4–10–85; 8:45 am]

BILLING CODE 4820–02–M

DEPARTMENT OF THE TREASURY
U.S. CUSTOMS SERVICE
WASHINGTON

NOV 19 1985

REFER TO
CLA-2 CO:R:CV:V
553849 HS

Stephen L. Urbanczyk, Esq.
Williams and Connolly
839 Seventeenth Street, NW.
Washington, D.C. 20036

Dear Mr. Urbanczyk:

This is in response to the petition you filed with the Customs Service pursuant to section 516(a), Tariff Act of 1930, as amended (19 U.S.C. 1516(a)), on behalf of the National Corn Growers Association, New Energy Company of Indiana, Ohio Farm Bureau Federation, Inc., South Point Ethanol, and Archer Daniels Midland Company. The petition challenges Customs view that azeotropic distillation of up to 190 proof ethanol in a beneficiary country of the Caribbean Basin Initiative (CBI) program to 199+ proof ethanol makes the 199+ proof ethanol a product of the CBI beneficiary country entitled to duty-free treatment.

This response, written pursuant to 19 U.S.C. 1516(c) and 19 CFR 175.22(b), is to notify you that we have reviewed your petition, your additional submissions, and all other submissions received as the result of our notice published in the Federal Register on April 11, 1985, (50 F.R. 14250) and have determined that the Customs classification is correct.

Over 45 comments were submitted in response to the published notice. Many of these comments discussed policy issues regarding the Caribbean Basin Initiative. However, it is our view that there is only one controlling issue in this case: whether azeotropic distillation of 190 proof ethanol to 199+ proof ethanol is a substantial transformation.

It is argued by the petitioner and other commenters that the azeotropic distillation process neither creates a new or different article of commerce nor involves substantial processing.

A brief description of the azeotropic distillation process is as follows:

> At 190+ proof, ethanol will have formed an azeotrope with water and other impurities that must be removed before the ethanol can sucessfully be blended with gasoline to make gasohol. As an azeotrope is a

constant boiling point liquid, traditional distillation processes are ineffective to break the azeotropic system. Thus, to produce ethanol suitable for blending to make gasohol, the azeotrope must be "cracked" using a Ternary Azeotropic Distillation process, whereby a third chemical is added to the ethanol solution to form a new mixture. This chemical is called an entrainer and is usually benzene, although cyclohexane, di-isopropyl ether, and gasoline have also been used. The entrainer forms a ternary azeotrope which is mainly water and benzene with a boiling temperature different from water. This temperature varies widely with the relative concentrations of ethanol, entrainer, and water. In addition, flow rates and pressures become critical control variables. Once the ternary azeotrope solution is separated from the ethanol, its vapors are condensed and sent to another distillation column to separate the benzene and trace amount of ethanol from the water.

Among the arguments set forth as to why 199+ proof ethanol is not a new and different article of commerce than ethanol of up to 190 proof are: (1) there is no chemical change between the 190 proof and 199+ proof alcohol -- the only difference is that water is removed; (2) there is no clear distinction between hydrous and anhydrous ethanol for many industrial uses; and (3) hydrous ethanol is used in Brazil as motor fuel.

It is Customs view that the extra 5 percent water that is missing from the anhydrous ethanol which causes the difference in specification is significant enough to make the anhydrous a new or different article of commerce. It is the absence of water that makes 200 proof ethanol suitable for particular uses, while it is the presence of water that makes 190 proof ethanol unsuitable for those same uses. Also, 190 and 200 proof ethanol have different freezing points, boiling points, densities, viscosities, vapor pressures and flash points.

Further evidence that 190 proof and 200 proof ethanol are different articles is the price differential between the two. For the past year, the Chemical Marketing Reporter has stated that the price of tax-free absolute ethanol is 12 cents per gallon higher than that of 190 proof tax-free ethanol. There is a price difference of about 8 percent. A price difference of about 5 percent is to be expected since the anhydrous product contains 5 percent more alcohol, but a price difference of 8 percent reflects, in part, the additional dehydration steps involved. By way of comparison, the price difference between two different grades of glycerine (99.5

percent and 96 percent) correlates almost exactly with the glycerine content of each, reflecting the fact that here the purer grade is subjected to a longer, but not a different, purification process.

Regarding the claim that 190 proof ethanol is used as motor fuel, the Brazilian government built a fleet of motor vehicles that used 190 proof ethanol as a defense against rising oil prices, but those vehicles and others like them were specially designed for that use. The modifications needed to enable the average car in the United States to use 190 proof ethanol would be more than minor and such vehicles are not commercially available in the United States.

In the United States, gasohol can have a maximum of 10 percent anhydrous ethanol according to EPA regulations. Only absolute ethanol can be blended with gasoline and technical references examined by Customs indicated that for ethanol to be blended with gasoline, to make gasohol, the entire fuel delivery system from refinery to tank trucks to undergound tanks in filling stations, must be dry. Water, even a small amount, will "split" the blend, causing the blend to separate into an aqueous phase and a hydrocarbon phase. Accordingly, it is Customs view that anhydrous ethanol has a use in the United States -- for blending to make gasohol -- that hydrous ethanol will not serve. While hydrous and anhydrous ethanol may both serve some industrial uses, our research reveals that anhydrous ethanol even when used for industrial purposes is used generally for purposes where water cannot be tolerated, such as in certain chemical manufacturing processes and for certain solvents.

The arguments that azeotropic distillation is not a substantial processing operation are that (1) dehydration is merely the opposite of dilution and dilution is clearly not considered a sufficient operation to entitle an article to duty-free treatment pursuant to section 10.195, Customs Regulations; (2) azeotropic distillation is just a simple boiling and cooling procedure; (3) the process does not require many workers; (4) the incremental capital, energy and labor requirements are miniscule when compared with the total cost of converting agricultural feedstock to ethanol, and (5) there is no significant distinction between proof enrichment from 194-199+ and from 190-199+, and Customs has ruled that enrichment from 194-199+ would not be sufficient to entitle the ethanol to duty-free treatment.

It is Customs view that if removal of water were to be considered per se an operation not sufficient to entitle an article to duty-free treatment under the CBI, it could have

been listed in the statute or regulations as easily as dilution was listed. Further, the addition of water to a product is generally a much more simple process than removing water.

Azeotropic distillation is more than a simple boiling and cooling procedure. The process involves complex equipment, sensitive instruments and trained personnel. In the particular operation challenged in this petition, the equipment includes a dehydration column over 150 feet high and 7 feet in diameter, over sixty stainless steel trays, each with nearly a hundred valves, plus weirs and downcomers, all manufactured to exacting standards. The Entrainer Recovery Column is 90 feet tall, 3 feet in diameter with nearly 60 stainless steel valve trays of its own. There are reboilers, heat exchangers, condensers, reflux tanks, decanters, surge tanks, vents, interconnecting piping, instrumentation, valves, pumps, meters, structure and mechanical systems required to maintain these columns.

In Uniroyal, Inc. v. United States, 542 F Supp. 1026, 3 CIT 220, aff'd 702 F2d 1022 (Fed Cir. 1983), the court stressed that factors such as cost and skill can be considered in determining whether a substantial transformation has occurred. In this case, the personnel must be trained to correctly monitor the azeotropic distillation process, and there has been an ample capital investment.

According to one comment, the drying process, per se, is not complex. Any complexity associated with the ternary distillation and directly associated process steps is in the design of the equipment and control apparatus. It is our view that the technical nature of the design of the equipment and the skill required of the workers to operate and monitor the system is of sufficient complexity to take the operation out of the simple combining, packaging or mere dilution categorization. While the number of workers involved in any specific operation is a factor to be considered in determining whether a substantial processing operation has occurred, it is not a controlling factor. In this particular case, we believe that the amount of local employment involved in the operation would not deter us from finding substantial processing.

We do not agree with the argument that the conversion of 190 proof ethanol to absolute ethanol is a minor step in the manufacture of ethanol from grain and therefore cannot be a substantial transformation. Obviously, the relative cost of

any one step in an overall process will decrease as the number of steps increases. Further, each operation must be examined on its own as to whether it is a substantial transformation.

Finally, Customs holding in a General Headnote 3(a) case that there is not a substantial transformation when ethanol of 194 proof is brought up to 199+ proof through azeotropic distillation was based on the fact that an entire azeotropic distillation operation was not occurring in the insular possession. Customs looks at all operations on a case-by-case basis in determining whether substantial transformation occurs. In the particular case where an operation was proposed to make ethanol anhydrous from a level of 194 proof, it was Customs view that since a partial azeotropic distillation operation had already occurred, merely finishing the azeotropic distillation operation in the insular possession would not be sufficient to make the 199+ proof ethanol a product of that insular possession. In this instance an entire azeotropic distillation operation is occurring in the beneficiary country.

In summary, after reviewing the petition, supplemental submissions and all the comments received, Customs has decided to continue to consider the azeotropic distillation of up to 190 proof ethanol to 199+ proof ethanol in a beneficiary country of the Caribbean Basin Initiative a substantial transformation of the ethanol making the 199+ proof ethanol a new and different article of commerce entitled to duty-free treatment.

Sincerely,

Harvey B. Fox
Director, Classification
and Value Division

Mr. JENKINS. Mr. Russo.

Mr. RUSSO. Thank you very much, Mr. Chairman.

I always enjoy a free flow of ideas. Thank you for them.

But I guess the bottom line is that the question that I have resolved in my mind is whether I would like to have something like wine alcohol quickly changed into ethanol through a very, very inexpensive process versus full fermentation, which is what I always understood in reading the testimony that the companies would ultimately go to.

That's why I come down on that end.

And just to say—I'm sorry the chairman is not here—I've been on the losing end. I'm getting stuff stuffed down my throat by the chairman, so he's not the only guy that is compelled to accept things he doesn't like.

But so we all understand the art of compromise in the legislative arena. So, is he here? Well, maybe he can respond sometime.

Let me just ask you—you're not here. You're temporary. I don't fool with guys like you. [Laughter.]

Let me just ask this question of Tropicana.

As I understand, in 1986, Mr. Vin who then was the president of Tropicana stated before the Ways and Means Committee that he needed 4 years to convert the Tropicana facility to a full fermentation processing plant.

As I understand, you have been in operation for more than 4 years now. Can you provide the committee with a status report on your progress toward a full fermentation plant?

Mr. MALONEY. Certainly.

I'd like to say initially that Mr. Vin no longer is with Tropicana. He's still in the——

Mr. RUSSO. Did Tropicana exist in 1986?

Mr. MALONEY. Yes; but I just wanted to state that.

Mr. RUSSO. He did make that statement on behalf of Tropicana, didn't he?

Mr. MALONEY. Yes.

Mr. RUSSO. Where are you?

Mr. MALONEY. Where we are now—when we first invested in ethanol dehydration, our idea was that we could create a magnet plant for the Caribbean and all with the same good intentions that everyone else has talked about, have indigenous production come through our plant, and create a new industry for the Caribbean.

Unfortunately, we have not been as successful as we had hoped in that process.

Mr. RUSSO. Because it is economically not feasible to do it, right?

Mr. MALONEY. Well, in 1986—in early 1986, we had an entirely different set of economics. At that time sugar prices were very low, and everyone was saying they were going to stay there. Oil prices were very high, and everyone was saying they were going to stay there and go higher.

What we had was sugar prices go up greatly, and our prices fall.

Now, I personally traveled the 16 Caribbean countries in search of either producers who would convert their sugarcane into producing ethanol to sell to our facility or to try and find an opportunity where we could ourselves vest in sugar estates, sugarlands, to create our own production.

It's not that easy of a task to just go and do that. We did take over, in July of 1986, the Duck and Field sugar estate and factory in Jamaica.

The idea was that there would be some potential there and that we could make some feedstocks and thereby control our own feedstocks. Now, since we've taken that over, in 1987, our first year of operation, the mill engine blew up; our entire crop was ruined.

In 1988, Hurricane Gilbert came through Jamaica and totally destroyed our estate.

The point I want to get across is that we have been trying; we are willing to work that way. We are committed to the Caribbean, but it's just not that easy.

Mr. RUSSO. No, I never said it was.

Of the total number of gallons that you exported to the United States over the past 4 years, how much of it was processed from European wine? And how much was produced from the sugar cane?

Mr. MALONEY. I would say that the majority of it would be from European wine. I don't know the exact quantity of sugar cane, but based alcohol, but there was some.

Mr. RUSSO. When you say, "majority," you mean 51 percent? Sixty-five percent? Seventy-five percent? I don't know what the majority is.

Mr. MALONEY. We purchased several million gallons from the Caribbean, but I'll get the figures and supply them for the record if you'd like.

Mr. RUSSO. Where do you market your ethanol in the United States?

Mr. MALONEY. We sell all of our ethanol into the gulf, into Louisiana; and that's about where my knowledge ends.

Mr. RUSSO. That's where it lands, right?

It lands in Louisiana. It lands in basically three places, I understand: Louisiana, Virginia, and Maryland. Yours is just basically Louisiana.

Where does it go from there? Does it go to the western market? Do you have any markets in the west?

Mr. MALONEY. I'm with Tropicana International, and the product goes into Tropicana Energy Co. Now, I do not know the exact markets where they ultimately sell the gasoline products that we sell, which happens to be ethanol.

I do know, interestingly enough, that at one time, Archer Daniels Midland took a significant quantity of our product in Louisiana.

Mr. RUSSO. Well, that may be okay, but in doing it it may have been a smart investment for them; I don't know.

But I've always heard what everyone's trying to do is to expand into the coastal markets where my good friend from California is from. He wants to get an ethanol supplier.

Do you have any coastal markets that you're developing? Or do you have the markets? Who does that? You don't do it? You just get it here to the United States and you let Tropicana Energy take care of it?

Mr. MALONEY. That's a fair statement.

Mr. VAUGHN. Mr. Russo, if I could interject.

Tropicana has blending terminal facilities in Minnesota, Kansas, Illinois, Nebraska, Iowa, Tennessee, and Texas. The coastal markets, I guess you would have to include Illinois; it's on the Great Lakes coast, but these are not coastal markets that they have developed.

Mr. RUSSO. No, but I am just trying to find out—and I had an idea that's where it was marketed, but I want to know if they are going to the west coast, because Mr. Matsui is concerned that if we shut it off he isn't going to get anything, so——

Mr. MALONEY. No.

Mr. RUSSO [continuing]. I want to make sure somebody, if we open up a little bit, that he gets it.

Mr. MALONEY. All right, I'm one producer in the Caribbean. There are others.

Mr. RUSSO. It's only a transition rule.

Mr. MALONEY. I can affirm we have sold into the California market in the past. I'm aware of that, but again I'm one producer and there are other suppliers that are going to be talking later.

Mr. RUSSO. From what I understand, they don't really do that. They go where—you know, the State has some good subsidies for this product, and basically it competes right with the domestic industry, from what I understand.

Mr. MALONEY. Congressman, generally, you will find that the State subsidies are producer credits for people who produce in those States, and a Caribbean product is not eligible for State tax breaks.

So, you will more naturally, I believe, find products going to those States where there are no tax breaks whatsoever.

Mr. KIRK. Mr. Russo, if I could add, I think the ITC report, if you look through it carefully, basically found that the coastal markets were the outlets and the logical extension for new markets for the CBI product.

Mr. RUSSO. Well, you know, the ITC report indicated that it lands at these ports. It didn't make any determination where it goes once it lands.

Mr. KIRK. Correct, but it did point out the cost would make it prohibitive to hit some markets. Our cost of production in the Caribbean, in most circumstances that I am aware of, is higher than the costs of production of most United States producers.

Mr. VAUGHN. You know, it's important that maybe I interject here with these State incentives that there are 18 States that offer State incentives. Four of the seven States where Tropicana markets are open incentive States, which means that Tropicana's product fully qualifies for those State incentives: Minnesota, Illinois, Nebraska, and I believe Iowa as well.

Mr. RUSSO. Is there any other source of alcohol feedstock that you can use, other than European wine in the dehydration facility?

Mr. MALONEY. At the present time there are none that I'm aware of.

As I mentioned, we have been trying to develop resources in the Caribbean. That has not gone very well, but, no.

Mr. RUSSO. I don't have any other questions.

Mr. JENKINS. Mr. Matsui?

Mr. MATSUI. Thank you, Mr. Chairman.

I just have a few.

Mr. Shepard, you're in the ethanol business, is that right?

Mr. SHEPARD. That's correct.

Mr. MATSUI. And how many gallons a year do you produce on the average?

Mr. SHEPARD. Something in excess of 30 million.

Mr. MATSUI. That's small production, is that right? You must have some other activities as well.

Mr. SHEPARD. That's correct.

Mr. MATSUI. What other activity?

Mr. SHEPARD. Well, we are a corn miller, so we make a range of starch products, and a range of corn sweeteners.

Mr. MATSUI. So, ethanol is really a byproduct of your principal operation; is that correct?

Mr. SHEPARD. Well, I wouldn't call it a byproduct——

Mr. MATSUI. Yes, maybe I——

Mr. SHEPARD [continuing]. In the traditional sense of a byproduct.

Mr. MATSUI. Overall, what percentage of your business would you consider to be ethanol?

Mr. SHEPARD. Just off the top of my head, I don't know that number.

Mr. MATSUI. But you are the owner of the company?

Mr. SHEPARD. No.

Mr. MATSUI. I'm sorry.

Mr. SHEPARD. No.

Mr. MATSUI. What is your role?

Mr. SHEPARD. I'm with A.E. Staley, which is one of the Taten Lyle Co., publicly held.

Mr. MATSUI. What is your role with the company then?

Mr. SHEPARD. I'm vice president of marketing for ethanol and sweetening products.

Mr. MATSUI. Would you say it is 50–50?

Mr. SHEPARD. No.

Mr. MATSUI. It's a lesser share?

Mr. SHEPARD. That's correct.

Mr. MATSUI. There are a number of products, and ethanol is one of the products?

Mr. SHEPARD. That's correct.

Mr. MATSUI. If you are in marketing, obviously you are doing some long-term projections; is this correct?

You foresee this ethanol market expanding, do you not?

Mr. SHEPARD. We hope so.

Mr. MATSUI. Well, you do see it expanding, I mean——

Mr. SHEPARD. Yes.

Mr. MATSUI [continuing]. With the clean air problems that we have, the carbon monoxide problems?

Mr. SHEPARD. Yes, but that's not guaranteed.

Mr. MATSUI. No, I know nothing is guaranteed any more.

Mr. SHEPARD. Right.

Mr. MATSUI. But you do see an expansion from your studies——

Mr. SHEPARD. That's correct.

Mr. MATSUI [continuing]. And from the analysis that you have been doing, is this correct?

Mr. SHEPARD. We think it has substantial potential, yes.

Mr. MATSUI. Right.

And under the current circumstances, where there is a rather significant government subsidy, in terms of grain, in terms of sugar, and also at the fuel pump, the excise tax has decreased significantly. As long as that remains, and I question whether that's going to remain after it expires, just from listening to my colleagues. I'm starting to feel that way, too; but that's another issue completely, and I won't get into that today.

But, assuming that it continues for a while, you will be able to continue to operate, right?

If the market expands?

Mr. SHEPARD. Yes, right.

Mr. MATSUI. In view of that fact, and the fact that the Caribbean countries right now are bringing in about 3 percent of the total market, please reconsider your comment that you feel that they could come up to 12 percent of the market if they get 100 percent of the excess European alcohol. That is provided the market remains the same.

Now, you don't really believe that, do you? That they are going to get 12 percent of the market?

Mr. SHEPARD. I think the potential exists for that.

Mr. MATSUI. Well, do your surveys show that the market is going to expand?

Mr. SHEPARD. No. Well, yes, but I suspect we are on different growth curves here.

Mr. MATSUI. Well——

Mr. SHEPARD. I think a lot of water has to go over the dam to get the kind of expansion which I am perceiving you have in mind in the ethanol market.

Mr. MATSUI. Well, that may very well be, but both the ITC and GAO have said that that's a worst-case scenario. In other words, they are not going to get 100 million gallons from the Europeans, are they?

Mr. SHEPARD. I don't know what they are going to get.

Mr. MATSUI. All right, but, then I guess your statement was not really meant to be an expert statement.

I don't have any further questions.

Mr. VAUGHN. Mr. Matsui, can I interject a thought and maybe to help something out.

The Congress in its wisdom granted the grandfathers and set the level at 20 million gallons per company and established that at five companies.

Repeatedly now, for 3 hours, we have heard—2½ hours, it seems like 3 hours—we have heard references to 3 percent, no more than 28 million, the GAO study says.

If that's the case, why set grandfather content levels that would provide for the opportunity to get the maximum level of European alcohol, No. 1.

And, No. 2, 27 or 28 million gallons coming from the Caribbean Basin and dropped off the first stop up the Mississippi River is Memphis. While granted, we'd like to see them develop the Boston market. We'd like all 28 million gallons to go to Sacramento.

Sadly, much of it has gone into the heartlands of domestic ethanol industry. Twenty-eight million gallons into Memphis, for example, or 100 million gallons up the Mississippi River in the open exemption States will create serious disruption. Twelve percent or three percent, it will in fact have a disruptive influence.

If you are telling us though, that the maximum allowable level for these grandfathers will be 28 million gallons, I don't think we need to go on much further with the hearings.

Mr. MATSUI. Well, when you talk about disruptions, you are really talking about a short-term phenomenon. If, in fact, there is a glut of oil in that region of the country, I hope you'll use some common sense, and try to find other markets, like the west coast. That is exactly what we have been saying.

Mr. VAUGHN. But you have the situation——

Mr. MATSUI. That's the way to get the ethanol out to the west coast.

I mean, you are not going to hit yourself on the head and say, let's stay down there anyway while there's a glut. I can't believe that. But maybe that's why we're here.

Mr. VAUGHN. Mr. Matsui, we've spent 8 years developing market activity, tankage, supplies, rail lines, end lines, blending equipment—all throughout the Midwest. You have market penetration levels in some States exceeding 30 percent. That didn't happen. That was hard, conscientious work by the domestic ethanol industry.

What you're suggesting is that we should go out and explore and develop the west coast market, a very difficult market to get to from the Midwest, when the domestic ethanol industry is already developed and is expanding into the coastal markets.

We'll sell 150 million gallons of ethanol this year in the coastal markets, and we don't like the idea of having wine processed in the Caribbean Basin, heavily subsidized, and very cheap, being dumped into existing ethanol markets.

If it went to Boston, we wouldn't be here arguing with you about it.

Mr. MATSUI. Well, let me just say this: You will find a way to get to these other regions of the United States. I can assure you that once you realize the playing field that you are playing in, you'll find a way to do it, if you want to remain competitive and remain in business.

I have to believe, unless I have a great misunderstanding about American ingenuity, we'll find a way to do it.

Mr. KIRK. Mr. Matsui, if I could comment on that.

I think that the exchange that you had, with all due respect to my good friend Eric Vaughn, illustrates part of the problem in understanding this issue.

GAO and the ITC have recently held on-the-record hearings where we provided proprietary information, and all the other Caribbean producers provided proprietary information. I assume that, you know, maybe members of the domestic industry did this as well. Notwithstanding this information, Mr. Vaughn continues to argue several things that cause us great distress.

First of all, he says that there's head-to-head competition, displacement. You had gone through this whole investigatory process,

and you heard the two witnesses from ITC, GAO, and said there is not one shred of evidence to justify that.

So, you know, there is a question about theory and reality. You have heard them say that they are trying to get into the coastal markets, and they are selling so much in the coastal markets.

I will assure you that if you go out and call some ethanol producers and some users, some gasohol users in California for now and through the balance of this year, you are on the on-again, off-again system, because most of the ethanol producers now are producing corn sweeteners for the upcoming sugar market, the upcoming soft drink market, and candy market. It happens every spring, and summer.

In fact, we have some survey data. We are aware that the committee has received some letters from some of these people who are in end users where they have called ADM, they have called A.E. Staley, they've called Peak, and said, can you guarantee us an assurance of supply for the long term or even for the next 3 or 4 months? And the answer has been no.

Copies of these letters came to our office, and I assume the committee has received those as well.

So, this is part of our problem, Mr. Chairman—we have these theories and the reality. That's one of the reasons why the Caribbean wanted to have the studies done, so that there could be a third-party, independent, factual base established from which policy could be made.

Mr. VAUGHN. Bill, there are currently, in the United States, some 4,987 ethanol marketers and blenders. If there are three that you found that said they couldn't get a 3- to 4-month commitment, I am not surprised.

But there are 4,984 ethanol blenders and marketers who are getting adequate supply.

Mr. KIRK. Those three blenders happen to control about 75 percent of the market, and you add two others, and that's about 90 percent of the U.S. ethanol market.

Mr. VAUGHN. Well——

Mr. MATSUI. Well, if I may, Mr. Chairman, perhaps I should submit these letters for the record if they haven't been.

But Hartley Oil Co. in Forest View, IL said in a letter to Mr. Gibbons:

> I would like to point out the difficulties of my company Hartley Oil has had, and continues to have in purchasing fuel grade ethanol for blending with gasoline.

It goes on.

And another one from El Paso Refining Co., Ltd.; and another one from S&F Petroleum Co., Inc.

And I know that we have had that problem too, because in my own State we have had problems getting ethanol. I think it is just a question of just a little more ingenuity.

Mr. VAUGHN. One of the most important factors in the development of the industry is something Mr. Dargan and you, Mr. Matsui, discussed earlier today, which is the growth generated from the clean air, clean fuels perspective.

And we are really excited about that growth. I must point out, though that 6 months ago, five ethanol manufacturers shut down

because of dramatically-increased grain prices, and a fall-off in oil prices.

That situation now has turned around slightly with oil prices up, grain prices down slightly. But the fact is that the ethanol industry is very conscientious and excited about the growth potential. We are, as I said, selling ethanol in coastal markets, and we are growing in those regions.

There is no dispute whatsoever with you, with regard to current blenders and marketers not able to get some product in some markets, and we would encourage our Caribbean Basin friends as they move into full fermentation, also move into full-scale market development in those areas, develop those markets, expand those markets, and use their full fermentation product for those markets.

Mr. MATSUI. Mr. Chairman, my time is up now, and I would just like to make one concluding comment here with respect to this panel and my time.

It's just unfortunate that you have an industry as heavily subsidized as the ethanol industry now saying they don't want competition. It's just absolutely mind-boggling to me that an industry that has been before the Congress seeking the kinds of subsidies that this domestic industry has sought, is now complaining about competition.

That just shows you something about where our country is going. If this is the entrepreneurial spirit, we're in trouble.

Mr. VAUGHN. The domestic ethanol industry, though, is——

Mr. JENKINS. The gentleman's time is over.

Mr. Guarini will inquire.

Mr. GUARINI. Thank you, Mr. Chairman.

As I understand it, all that's produced in the Caribbean comes into the United States. There is no other marketplace for it, is that correct?

Mr. MALONEY. At the present time, yes.

Mr. GUARINI. Right.

But there is a potential in other parts of the world?

Mr. MALONEY. I think at one time we looked at a potential of Canada, but their program's behind, and right now there is no other—there is nothing on the short-term horizon.

Mr. GUARINI. And is there any fine competition that the United States has other than these two countries, Jamaica and Costa Rica, where they have ethanol plants today?

Mr. VAUGHN. In terms of duty-free access to the United States? Not that I am familiar with.

Mr. GUARINI. Do we import ethanol from anyone else?

Mr. VAUGHN. There are some 80 GSP countries that at one point could produce.

Mr. GUARINI. No, no.

Do we import any ethanol from any other countries?

Mr. VAUGHN. Not at the present time that I am aware of.

Mr. GUARINI. So, you virtually have the market to yourselves, we're talking about, almost restricting free trade then? Because what you are really talking about is that you want to control the marketplace?

That's the way I have interpreted the testimony I've heard so far.

Mr. VAUGHN. Well, when the Congress established the incentive program, the incentive was devised as a way to accomplish several objectives—expand new markets for agricultural commodities, to enhance energy security——

Mr. GUARINI. But they didn't say they were going to give you a monopoly though?

Mr. VAUGHN. And that monopoly has never been there. In fact, Congress in its wisdom shared this monopoly, this program, this opportunity with the Caribbean Basin ethanol industry.

What I was trying to point out to Mr. Matsui earlier was that the ethanol industry has marketed very heavily and very actively ethanol produced in the Caribbean Basin in the earlier years from some of the several, the full fermentation plants in the region.

Mr. GUARINI. But is there enough ethanol being produced for consumption in this country? Is there a scarcity of ethanol? Could we use more considering the fact, you said, it's an environmental problem, it gives you clean air and that it has not only economic factor, but it also has environmental factors.

Mr. SHEPARD. To my knowledge, at the present time, there is not an ethanol shortage, to my knowledge.

Mr. GUARINI. So you have no problem with your company as far as the economics of running your company are concerned?

Mr. SHEPARD. I'm sorry?

Mr. GUARINI. There's no problem with the economics of running your company? You are not being hard pressed by foreign competition or jobs endangered or your business being threatened, are you?

Mr. VAUGHN. No.

Mr. GUARINI. Then I don't understand what the big brouhaha is except if you want to have the whole ball game to yourself. That's the way it seems to me.

Mr. VAUGHN. The question is one of at what level does European wine alcohol become a serious concern or a serious problem?

Mr. GUARINI. To who?

Mr. VAUGHN. To ethanol manufacturers.

Mr. GUARINI. I mean to the wine market or to your industry?

Mr. VAUGHN. There should be no impact whatsoever on the domestic wine market, I would assume. But, in terms of the domestic ethanol industry, there could be a significant impact.

As I pointed out that the marketing that's taking place today, obviously a very small amount of alcohol, but its marketing is in the developed ethanol industry marketplace.

Mr. GUARINI. Well, are you competitive?

Mr. VAUGHN. With wine related alcohol? No, we're not.

Mr. GUARINI. With the 3 percent that's coming into the country?

Mr. VAUGHN. We are not competitive with the alcohol being processed from European wine made alcohol. That's correct. We are not today.

Mr. GUARINI. Well, what is the cost per gallon that you have as compared to the cost per gallon that comes from Jamaica and Costa Rica? Is there a big spread?

This is not a labor intensive business. It's basically a capital intensive business, isn't it? It's capital oriented?

Mr. VAUGHN. Dehydration in this business?

Mr. GUARINI. Yes, right. And you wouldn't lose a lot of jobs, would you, if you had competition?

Mr. VAUGHN. The dehydration business is indeed not labor intensive. It's, quite frankly, not even capital intensive. The capital intensive activity, which is what the Congress asked the ethanol industry to do, to invest in full fermentation plants in return for a domestic marketing incentive. That's what the Congress put in place. And $2.5 billion in resources were invested in those facilities.

Mr. GUARINI. Well, that's the risk of going into business.

Mr. VAUGHN. Absolutely.

Mr. GUARINI. Now, you have an escape clause, section 201, if you want to use it, if you feel you're being injured. Are you being injured? Have you ever filed an escape clause, section 201 proceeding?

Mr. VAUGHN. Someone used the term "fraud" earlier. No one has ever alleged that this is a fraudulent activity.

Mr. GUARINI. Escape clause is not a fraudulent activity. If your market is being, you know, impounded, or if your market is being destroyed by foreign competition, there is a way out under our trade laws if you were willing to be under the normal trade laws that every other industry in our country has. And you seem to want a certain special kind of a provision that's tailor-made for your own industry which you control, and I don't understand it.

Mr. VAUGHN. Well, in terms of the 201 filing, it's normally necessary to have suffered that injury, to suffer that dislocation, to suffer plants being shut down before you file.

Mr. GUARINI. So you're doing very well then?

Mr. VAUGHN. What we are pointing out to the Congress today is that there is the potential for a serious problem. Three-percent market penetration is not a serious problem.

Mr. GUARINI. I fail to see how your industry is that much better or should be more privileged than any other industry that we have in our country, where we have GATT, and we have free trade laws, and we have sections 301 and 201, that there's adequate protection. Your industry is not hurt. There is a scarcity of material.

One thing that surprises me is that you are taking the trouble to this committee.

Now, let me ask you, are you for helping the Caribbean area and the Caribbean Basin countries lift themselves up economically, which are our neighbors and which have a national defense repercussion to our country? Are you for a CBI-2 bill to improve our trading with our neighbors?

Mr. VAUGHN. Our domestic ethanol industry, and I believe many of the national farm organizations are extremely enthusiastic about the Caribbean Basin Initiative. We did not contest nor did we seek to eliminate ethanol from the original CBI legislation.

The objective we thought, and we think the Congress felt at the time, was a new alternative energy industry from surplus sugar cane in the region. The fact that some entrepreneurs took advantage of wine-like alcohol to subvert that intent is the reason we are taking the time of this committee, why we think it is an extremely important issue that deserves your attention.

Mr. GUARINI. Let me ask you, does it make it more competitive for you to have outside competition where the consumer in our

country would benefit by your being challenged on your cost by foreign competition.

Mr. SHEPARD. I think you're making it less competitive. You're making it less competitive——

Mr. GUARINI. Well, that means you get a higher price and that you should be better off. If your balance sheet is better, then I see no reason why you should be complaining.

Mr. SHEPARD. I think you are making it less competitive because, through this quirk of European wine alcohol, you are permitting some dehydrators to become the world's low cost producers, and that is affecting and has affected smaller—has the potential to affect smaller ethanol producers in this country.

Mr. GUARINI. Now, are you worried about your balance sheet or are you worrying about the balance sheet of the smaller producers? Are you representing the smaller producers in this industry? And you're not hurt at all.

Mr. SHEPARD. I'm representing the Renewable Fuels Association which has some small producers as members, and I am a mid-size producer and I'm worried about that too.

Mr. GUARINI. So you speak for your industry from your perspective, is that correct?

Mr. SHEPARD. That's correct.

Mr. GUARINI. All right. Mr. Kirk?

Mr. KIRK. Mr. Guarini, I would just like to add again, the reason why Congress asked GAO and ITC to do this comprehensive study, is so there would be a third-party independent source of information.

I would refer you to those two studies. Those two studies do not find that we are undercutting the price of domestic ethanol. They show that our costs are very high; that we don't have substantially less costs than they do.

Those studies again—and I would add to that we provided proprietary information, we participated on the record hearing. The RFA was there. I assume they were asked to provide proprietary information. If the information was there, there would be a finding of harm. There simply isn't any mention of evidence of harm in the report.

Mr. GUARINI. Mr. Chairman, if other industries came forward and this Committee had hearings of this kind, which took testimony concerning each one that wish to have protection, so they can control the market place, our calendar would be a sorry state of affairs.

I have no further questions.

Mr. JENKINS [presiding]. I want to express my appreciation to the panel. It sounds as if it's been a very lively discussion before I got here, and it's certainly been interesting since I arrived.

Thank you, very much, for your testimony.

Our next panel, Petrojam, represented by Mr. Timothy Columbus, Mr. Eugene Rossides, and Mr. Jim Southerland. I might say to the panel that your entire statements will included in the record, and I would ask that you summarize the statements. Then we'll get into the general discussion and questions.

We will begin, Mr. Columbus?

STATEMENT OF R. TIMOTHY COLUMBUS, COUNSEL, ON BEHALF OF PETROJAM LTD., KINGSTON, JAMAICA

Mr. COLUMBUS. Thank you, Mr. Chairman.

My name is Tim Columbus, member of the law firm Collier, Shannon, Rill & Scott, and I appear today on behalf of our client Petrojam Ltd., of Jamaica. As the representative of a foreign entity, I'm also registered as a foreign agent. I brought no trench coat, but I'm here on behalf of a foreign entity.

I'm sorry to be standing between you and the opportunity to leave this room. I do want to take a few minutes to point some things out. First of all, I'm sort of thrilled to be here. In one sense I'm sorry Mr. Russo and Mr. Dorgan left, because Petrojam is apparently the entity that doesn't exist.

Throughout today's debate one of the things that was emphasized is that no Caribbean producer has gone to full fermentation and distillation facilities. Someone suggested that there has not been—I think it was the man from Staley—suggested that there has not been any additional fermentation/distillation capacity brought on line. The fact is that Petrojam has done all those things.

Mr. Rossides, on behalf of the Costa Ricans, I am sure, will be happy to admit that his client exists as well.

Petrojam, while owned by the people in Jamaica, operates on a for-profit basis. Its charter also includes the stricture that it must operate for the benefit of the people of Jamaica. Petrojam receives no subsidies or special treatment from the Government of Jamaica. In fact, Petrojam does pay customs duties and taxes to the government.

Petrojam, and its affiliates, operate at the Bernard Lodge in Jamaica, a significant sugarcane estate, a cane processing factory, fermentation and distillation facilities, which were contracted for in 1985, paid for in 1986 and 1987, and installed in 1986 and 1987.

In addition to these facilities, in Kingston, Jamaica, Petrojam operates an anhydrous distillation tower—as any fuel ethanol producer does, and it's the last step in the process from growing the stuff to getting it out there in the condition you can use in autos.

The Petrojam fuel ethanol project directly, or indirectly, employs more than 2,000 individuals in Jamaica. I'd like to take issue with the comment from the ITC, contained in its report, and that is that these individuals are characterized basically as displaced sugar workers. The suggestion was made that should they stop participating in the ethanol business, they would go back to sugar business.

The Bernard Lodge was closed before Petrojam took it over. The people who are employed there today in the agricultural and fermentation/distillation activities were either underemployed or part-time employees, or unemployed entirely.

Should the project cease its operations, these individuals would be unemployed. Now you hear about 2,000 jobs in this committee day in and day out, but I want to point out that Jamaica is a country of 2,500,000 people. This is basically one-tenth of 1 percent of Jamaica's population that's dependent on this project.

In U.S. terms that's the equivalent of about 2.4 million jobs. To suggest that this project doesn't offer significant employment op-

portunity to the Caribbean Basin, at least in the country of Jamaica, strains credulity.

Petrojam has, to date, invested in over $20 million U.S. in its fuel ethanol project. There is an additional 8 million dollars' worth of investment that—I can talk to you in terms of the schematic that I attached to the statement—in planned investment. But, until the uncertainty about whether or not these people will be operating on January 1, 1990, is eliminated, the board of Petrojam, its parent controlling corporation in Jamaica, has stopped all further investment activity.

When completed—and Mr. Jenkins I know it's a pain, it's too bad the other guys aren't here, cause it's such a great picture. On the back of my testimony there's a schematic that shows what the Petrojam project is entirely. What the project, if it's completed—and we'll find as you folks work this problem out whether or not it will be completed—will produce or contribute to the production of, in addition to fuel ethanol, animal feed, electricity, fertilizer, and sodium carbonate, thereby creating additional employment and foreign exchange for Jamaica.

The schematic—it's too bad, I love this drawing, but I'll move on.

Mr. JENKINS. We will include it in the record.

Mr. COLUMBUS. I appreciate that, Mr. Jenkins. I worked hard on this. I was up late.

The reality is that, both the ITC and GAO, have confirmed a couple of very important things.

One, that the 75 percent domestic feedstock requirement, which is scheduled currently to kick in on January 1, 1990, is simply not feasible.

Secondly, those reports both indicate, at least to me, that CB produced ethanol has not, does not, and will not threaten the viability of U.S. ethanol producers.

Basically, our opponents—and we heard a pretty good explication of their views a few moments ago, based their opposition on three allegations.

The first allegation is that a realistic standard for beneficial treatment of Caribbean produced ethanol will not provide significant employment. As I said, employing one-tenth of one percent of a country is not a bad contribution to the economy of that country.

With respect to the idea that Caribbean production of fuel ethanol is simply a pass through, a flow through, for wine ethanol—there's no dispute here. There's no dispute that for the short term future, I'll say the next 5 years—whatever, given what we've seen over the last couple of years, European or some other non-Caribbean source feedstock, wine ethanol, is going to be essential to the production of any Caribbean ethanol. What I'm saying is the percentage of wine ethanol that we would include in the hydrous alcohol which we will dehydrate—if it comes from Europe—is the quid pro quo for 2,000 jobs.

When you look at this schematic, you'll see that it all drives the project. Petrojam's whole project is based on ultimately achieving 100 percent domestic content. How are they going to get there? They're going to market animal feed. They are going to market fertilizer, they're going to generate electricity, and from those ancilliary activities, all of which are centered upon the production of

fuel ethanol, and totally dependent upon the production of fuel ethanol, they will lower their cost so they can, in fact, compete long term on their own basis.

I am enormously distressed by the idea that this is some sort of pass through operation. I've had the opportunity to hear my client characterized that way any number of times, on the floor of the House, the floor of the Senate, and in this Committee, and it's simply not a fair characterization.

The final allegation is that, Caribbean producers of ethanol are, somehow, threatening the viability of U.S. producers of ethanol. The reality is that the ethanol market's in short supply. Both the GAO and the ITC found there to be no such threat, and that the market share of CB producers has been, and will continue to be, very small.

Petrojam respectfully requests, that this subcommittee in the immediate future—and I'm hoping this session of Congress—act in a way that will allow it to continue its operations, will allow it to continue to employ a significant number of people in Jamaica, and develop the kind of productive economic activity which was the promise of CBERA .

We sure appreciate this opportunity to express our views. I'll be happy to respond to any questions.

[The statement of R. Timothy Columbus follows:]

Before the
Subcommittee on Trade of the
Committee on Ways and Means of the
U.S. House of Representatives

Statement of
R. Timothy Columbus
on behalf of
Petrojam Ltd.

Regarding Fuel Ethanol Imports from
Caribbean Basin Initiative Countries

April 25, 1989

The History and Development Philosophy of Petrojam

My name is R. Timothy Columbus. I am a member of the law firm of Collier, Shannon, Rill & Scott and appear today on behalf of our client, Petrojam Ltd. of Jamaica. As the representative of a foreign entity, I am a registered foreign agent.

Petrojam Ltd. is a wholly owned subsidiary of the Petroleum Corporation of Jamaica ("PCJ"). PCJ was formed in 1979 for the purpose of increasing Jamaica's self-sufficiency in energy. PCJ's charter calls for it to explore for and develop Jamaica's indigenous energy resources, promote and encourage the national development of these resources, and promote technological development in Jamaica while protecting the environment.

Petrojam was formed following PCJ's acquisition in October 1982 of Esso West Indies Limited's hydroskimming refinery located in Kingston Harbor, Jamaica. Petrojam is engaged in the procurement, refining, and marketing in Jamaica and overseas of energy products, including ethanol. Petrojam is also the parent of Petrojam Ethanol Ltd., which runs Petrojam's dehydration facilities for ethanol production, and of Petrojam Belize, which runs Petrojam's sugar cane and planned ethanol production facilities in Belize.

Finally, in 1987, Petronol Ltd. ("Petronol") was formed also as a wholly owned subsidiary of PCJ. Petronol's purpose is to operate the sugar cane fields, cane processing factory, and distillation facilities in Jamaica (located at Bernard Lodge sugar plantation) and to produce the hydrous ethanol which Petrojam Ethanol will dehydrate and, hopefully, export to the United States market.

Petrojam and Petronol were formed following the acquisition of the Esso refinery, and the leasing of the Bernard Lodge facilities, respectively. The entire PCJ group of companies operates commercially and without any government subsidy or other financial contribution from the Government of Jamaica. These companies arrange and obtain all financing on the strength of their asset base and goodwill, without government guarantees or other assistance. Thus, Petrojam has arranged its own financing with international lending and private sector institutions at commercial rates. The only loan granted Petrojam by the Government of Jamaica was at its inception, in 1982. Petrojam discharged that loan a year later. In addition, a principal requirement imposed by the Jamaican government in connection with the 1982 acquisition of the Esso refinery was that PCJ guarantee that the selling price of products produced at the refinery would be dictated by market forces. PCJ guaranteed to meet the government's pricing objective by ensuring that Petrojam's refined products would be priced comparably to refined products imported into Jamaica from other producers. The objective of both PCJ and the Jamaican government was to ensure that Petrojam would not be a burden on the Jamaican economy, that is, would receive no subsidies or other state aids.

While the PCJ group of companies are operated on a for-profit basis, their underlying purpose is to serve a second highly important role, namely, to promote the economic welfare of Jamaica itself. The companies thus operate both to achieve greater energy independence for Jamaica and to promote economic development of the country through diversification of its traditional agricultural economy. Because the companies are not driven by strict profit maximization principles, they engage in certain activities, such as crude oil exploration, that profit-maximizing firms might not pursue. For example, through its ethanol project, Petrojam is committed to utilizing the highest level

of indigenous employment and maximizing economic benefits to Jamaica, within the aforementioned discipline of accepting no subsidies and earning a profit on its sales.

To meet the not always compatible objectives of economic development and profit, Petrojam has chosen to develop its potential to produce fuel ethanol, with the specific purpose of selling it in the U.S. market. Jamaican production of ethanol held promise first and foremost because of the duty-free status afforded imports under the Caribbean Basin Initiative ("CBI") legislation. At the time of Petrojam's decision to enter this market, the local content requirements under the Caribbean Basin Economic Recovery Act ("CBERA") — 35 percent value added — permitted the company to sell its product in the United States profitably. The change in this requirement to domestic content levels recently deemed unattainable by both the U.S. International Trade Commission ("ITC") and the General Accounting Office ("GAO"), however, has stopped Petrojam's ethanol project, and along with it, Jamaica's best chance at economic development, dead in its tracks.

Petrojam's fuel ethanol project is an integrated operation which employs, directly or indirectly, over 2,000 individuals in Jamaica. To date, Petrojam has invested in excess of $20 million (US) in the project.

The project currently consists of a renovated and replanted sugar estate and factory at Bernard Lodge where Petrojam is actively cultivating not only sugar cane but is also experimenting with alternative sources of feedstock such as sweet sorghum and specialized cane varieties to maximize domestic supplies of feedstock. In addition to the growing operation, Petrojam has renovated the Bernard Lodge sugar factory and has installed a fermentation and distillation facility to convert domestic feedstock into hydrous ethanol. The final stage of the project involves Petrojam's operation of its anhydrous distillation facilities which convert hydrous ethanol to anhydrous, fuel quality, ethanol.

The Petrojam project is only partially complete. Specifically, in addition to the facilities described above, the project contemplates the operation of an electricity-generating facility to be fueled by the consumption of bagasse, an animal feed facility employing the spent yeast from the distillation process, and other ancillary operations designed to lower Petrojam's costs and generate foreign exchange by decreasing Jamaica's dependency on foreign petroleum, animal feed, and fertilizer imports. (Attached for the Subcommittee's review is a schematic diagram of the project as it will function in its completed form.)

Each of the additional facilities contemplated within the completed Petrojam fuel ethanol project represents more Jamaican and Caribbean-based employment, economic development, and diversification away from traditional agriculture — exactly the kind of activity the CBERA legislation seeks to promote. However, that entire process, with all its attendant potential, is dependent on the initial step, the sale of fuel ethanol to the U.S. market. Since Caribbean ethanol must be able to compete for U.S. sales with its economic substitute, gasoline, the 1986 legislation setting unattainable domestic content requirements has effectively stopped Petrojam's backward linkage strategy and thwarted development not only in Jamaica, but also in Belize — another CBERA country — where Petrojam has sited another facility similar to those currently in place at Bernard Lodge.

There can be no doubt that Petrojam is committed to this strategy of backward linkage, and the replacement, whenever possible, of foreign inputs with Jamaican inputs, including the replacement of non-CBI feedstock with that produced in the Caribbean Basin by Caribbean Basin workers. Despite the uncertainties created by the change in U.S. legislation, Petrojam has already moved beyond the dehydration-only stage of ethanol production. In fact, the company has in place a comprehensive set of facilities for the production of ethanol from local feedstock. In 1986, Petrojam acquired the Bernard Lodge sugar plantation, 14 miles from Petrojam's refinery in Kingston, with the specific intention of growing sugar cane for use in the production of ethanol. At the time of acquisition, these fields lay fallow; their workers, under or unemployed. The process of clearing the fields and planting cane already is ongoing. In addition to rehabilitating the sugar mill at Bernard Lodge, Petrojam has constructed fermentation and distillation facilities to process the indigenous sugar cane from the mill and private farms into CBI-origin wet ethanol. As noted previously, construction of fermentation and distillation facilities are also planned for Belize.

In short, Petrojam did not wait for the U.S. Congress to act before it committed investment to develop its ethanol sector past the dehydration stage. Petrojam has stated numerous times (for example, see page 27 of the United States General Accounting Office Report to Congressional Requesters regarding Fuel Ethanol Imports from Caribbean Basin Initiative Countries, February 1989 ("GAO Report")) that ethanol earnings will be plowed back into CBI ethanol projects, and that whatever level of domestic content eventually required by Congress, Petrojam will maximize its indigenous feedstock and labor, subject only to the constraint of being able to sell its products economically in the United States.

Analysis of the ITC and GAO Reports

The cause for the current proceedings in the U.S. Congress is the economically unattainable domestic feedstock requirements of 60 and 75 percent set by Congress in 1986. Far from encouraging more local inputs and development of the Caribbean Basin ethanol industry, the requirements have effectively stopped further development and threaten to end all production and employment for those Caribbean producers after 1989.

To investigate the feasibility of the 1986 requirements, the Congress through the 1988 Trade Act requested that two U.S. government agencies, the U.S. International Trade Commission, and the United States General Accounting Office do feasibility studies on the 1986-mandated feedstock requirements, provide alternate recommendations if these requirements proved not feasible, and assess the impact of Caribbean Basin fuel ethanol imports on U.S. producers of the product.

The reports of the two agencies, both published in February 1989, are striking in the unanimity and certainty of their conclusions. Briefly summarized, both studies found the following:

1. The indigenous feedstock requirements of 60 and 75 percent are not economically feasible for CBI ethanol producers to meet under current market conditions. (GAO Report at 3; U.S. International Trade Commission Report to Congress on Investigation No. 332-261 Under Section 332(g) of the Tariff Act of 1930, Ethyl Alcohol and Mixtures Thereof: Assessment Regarding the Indigenous Percentage Requirements for Imports in Section 423 of the Tax Reform Act of 1986, February 1989 ("ITC Report") at 5-11.)

2. Both studies could perceive little impact on U.S. producers. The ITC report noted that U.S.-produced ethanol is predominantly shipped and consumed in the Midwest, whereas almost all CBERA produced ethanol is shipped to only three coastal states, Virginia, Maryland, and Louisiana. Further, the study noted contrary price movements of U.S. and Caribbean Basin ethanol, "which would seem to indicate that the two products are imperfect substitutes." (ITC Report at 403.) Contradicting the fear of some domestic interests, the ITC found that if maintained, recent increases in European wet ethanol prices "would render the close-to-cost operations of the Caribbean Basin producers noncompetitive with producers of fuel ethanol in the domestic U.S. market." (ITC Report at 3-10.) The GAO report found that Caribbean Basin ethanol imports peaked at only three percent of the U.S. market in 1987, and stated that imports "to this point have been relatively small." (GAO Report at 37.) The GAO also found no basis for the central concern of domestic interests opposing lower domestic feedstock requirements for Caribbean Basin ethanol: "It is questionable whether Caribbean producers can currently secure sufficient quantities of surplus European Alcohol stocks to supply 88 to 120 MGY (million gallons per year) capacity." (GAO Report at 37.)

Both the ITC and GAO reports cautioned that the feasibility of Caribbean Basin ethanol operations depended on several other variables in addition to the domestic content of the feedstock (or, the price of CBI wet ethanol). These include the cost of non-CBI wet ethanol and the price of gasoline in the U.S. market, which serves as an effective cap on the price of ethanol, its economic substitute. Citing the influence of these variables, the ITC report declined to recommend a domestic content standard, stating that it "is not possible to mandate a single feedstock requirement that will guarantee a CBI ethanol industry of any particular size that has a minimal effect on the U.S. ethanol industry." (ITC Report at 5-10.) The GAO offered three alternative feedstock requirements to the current unattainable levels:

i. set lower local feedstock requirements of 10 percent in the first year, rising to 20 or 30 percent in later years;

ii. eliminate the feedstock requirement, and reinstate the 35 percent value added test, because "the local feedstock requirement for ethanol (of the 1986 Legislation) changed the rules for a CBI product after investments had already been made." (GAO Report at 5.)

iii. Permanently extend a production "cap" of 20 MGY for companies now in existence, and establish a 30 percent or higher local feedstock requirement for additional production above the 20 MGY cap, or for all production of new plants.

It should be noted that all of these options reflect GAO's conclusion that any standards must be significantly less restrictive than the current 75 percent feedstock requirement if the program is to generate any jobs in the region over the long term.

Petrojam endorses the recommendations of the GAO that "[g]iven current sugar and gasoline prices, it is not economically feasible for CBI ethanol producers to meet the 75-percent local feedstock requirement. At current prices, CBI companies can be competitive with no more than 10 to 30 percent local feedstock requirement." (GAO Report at 3.) The estimates of 10 to 30 percent are realistic, and would allow the immediate production and export of Caribbean Basin fuel ethanol, with sufficient returns to assure the long-term development of the Caribbean economies, as envisioned by the CBI legislation. As proof of its commitment to maximize local inputs no matter what the requirements, Petrojam is meeting the current 35 percent value added requirement by utilizing indigenous feedstock in its dehydration operations. This allows Petrojam to realize a modest return on its ethanol operations. These profits are necessary to continue to implement Petrojam's strategy of backward linkages into cane production, fermentation, and distillation, and the development of other CBI (Belize) ethanol operations. Alternatively, Petrojam could endorse any of the three options developed by the GAO.

Petrojam must stress to the Subcommittee that the one option that Petrojam and other CBI producers cannot agree to is further delay and uncertainty. The members of the Subcommittee must realize that opponents of the Caribbean Basin ethanol industry, despite empirical studies by two respected U.S. government agencies rebuffing their claims of negative impact on U.S. producers, have so far won a great victory. Merely by delaying the implementation of an attainable domestic content requirement, and by continuing the uncertain investment climate, the opponents of CBI have already effectively assured that no new investment in ethanol or related facilities can be planned, financed, made, expended, or recouped before the sunset of the CBI legislation. They are working to delay implementation of an attainable feedstock requirement until that time when it would be impossible for current producers to make the necessary investments to gear up and export.

Petrojam respectfully requests that Congress act promptly, i.e., in this session, to enact an attainable domestic content requirement. Such prompt action is essential to permit the commitment of additional capital to long-term operations. Absent such action, Petrojam will be compelled, as it was in 1988, to cease operating its ethanol project. Termination of these operations will render Petrojam's investment valueless and result in a loss of employment for approximately one-tenth of one percent of Jamaica's population, a loss equal in U.S. terms to 2.4 million jobs.

Opponents of Congressional action to establish a realistic standard for Caribbean Basin ethanol producers have premised their arguments on three allegations: (1) affording beneficial treatment to this product creates no significant employment opportunities in the beneficiary countries; (2) operations such as Petrojam's are merely "flow through" facilities for European wine ethanol; and (3) that the establishment of a standard which permits, in an economic sense, CB producers to operate, threatens the economic viability of U.S. producers of ethanol and corn. An honest examination of the realities of the Petrojam project and the results of the ITC and GAO studies demonstrate the inaccuracies of these allegations.

Petrojam's project has created employment opportunities for approximately one-tenth of one percent of Jamaica's population. The Petrojam ethanol project is not designed as an alternative to the world sugar market, rather, because of Jamaica's unfortunate competitive posture in the world sugar market, fuel ethanol is to be the

exclusive outlet for the cane production dedicated to it. The facilities rehabilitated and operated by Petrojam were in disuse prior to the project's assuming their operation. Similarly, the individuals employed were either totally unemployed or underemployed. This project has therefore created employment in Jamaica equivalent for that country to employment of 2.4 million individuals in this country. To argue that such employment is insignificant strains credulity.

Petrojam's use of non-Caribbean basin feedstocks reflects simple economic reality. No entity can consistently sell a product at levels dramatically below its cost and continue to function economically. The use of non-Caribbean Basin feedstocks is mandated by prices in the U.S. market. Should those prices permit the use of additional Caribbean Basin feedstocks, Petrojam will immediately act accordingly to facilitate the achievement of its objective of maximizing employment opportunities as well as maximizing the economic benefits of the ancillary operations which are dependent upon the use of Caribbean feedstocks.

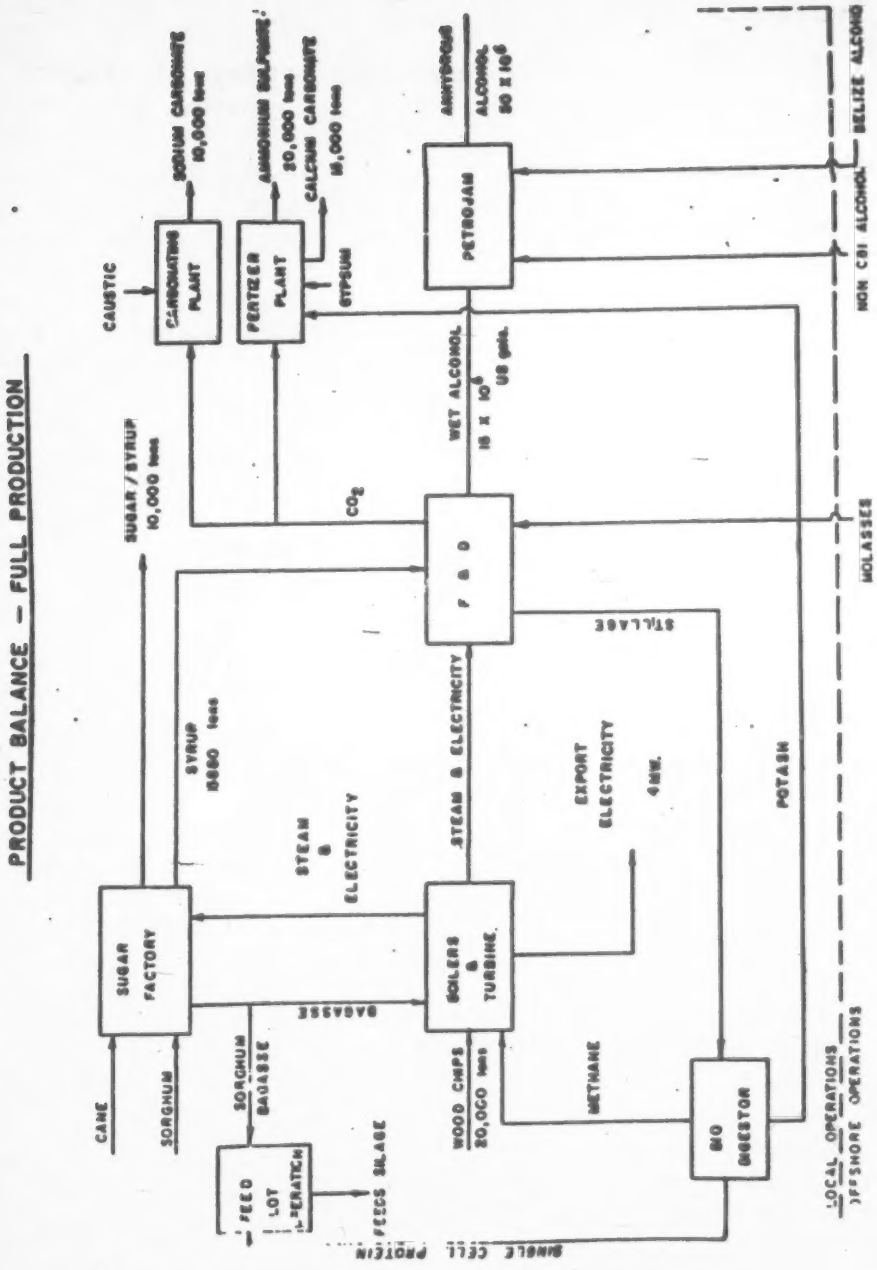
Finally, as both the ITC and GAO studies demonstrate, the existing facilities for the production of Caribbean fuel ethanol have not, do not, and will not threaten the economic viability of U.S. ethanol producers and their suppliers. The simple reality is that the domestic market for ethanol currently reflects levels of demand which exceed existing U.S. production. Moreover, the markets which will be served by Petrojam are in areas not adequately served at this time by U.S. producers.

In conclusion, Petrojam urges Congress to act promptly to fulfill the promise of the CBERA by resolving the current uncertainty which applies to the production of fuel ethanol in the Caribbean by establishing realistic standards for beneficial treatment of this product under the Caribbean Basin Initiative. Petrojam, in response to the promise of CBERA has invested over $20 million (US) in scarce foreign exchange resources in this project. It has responded to the promise of CBERA by creating thousands of jobs and generating the opportunity for diversified, productive economic activity in the Caribbean Basin. It is the moral obligation of a great country to keep its promise to those who have acted in the manner which that promise was offered to induce.

Jamaica has been a reliable trading partner of the United States. The promotion of productive economic activity in Jamaica, via the vehicle CBERA, will provide Jamaica the wherewithal to build on that historic relationship. The Petrojam fuel ethanol project has created the single biggest employment opportunity in Jamaica heretofore generated by CBERA. Petrojam respectfully requests that the promise of this project and the mutual benefits which it can produce for both Jamaica and the United States not go unfulfilled.

Petrojam appreciates this opportunity to express its views on this matter. I will happy to attempt to respond to any questions which my testimony may have raised.

The foregoing material is being disseminated by Collier, Shannon, Rill & Scott, 1055 Thomas Jefferson Street, N.W., Washington, D.C. 20007. Collier, Shannon, Rill & Scott is registered with the Department of Justice, Washington, D.C., under the Foreign Agents Registration Act as an agent of Petrojam Ltd. Petrojam Ltd., a corporation wholly-owned by the Government of Jamaica, can be reached at 96 Marcus Garvey Drive, Post Office Box 241, Kingston, Jamaica. This material is filed with the Department of Justice where the required registration statement is available for public inspection. Registration does not indicate approval of the contents of this material by the U.S. Government.



This material is being disseminated by Collier, Shannon, Rill & Scott, 1055 Thomas Jefferson Street, N.W., Washington, D.C. 20007. Collier, Shannon, Rill & Scott is registered with the Department of Justice, Washington, D.C., under the Foreign Agents Registration Act as an agent of Petrojam Ltd. Petrojam Ltd., a corporation wholly-owned by the Government of Jamaica, can be reached at 96 Marcus Garvey Drive, Post Office Box 241, Kingston, Jamaica. This material is filed with the Department of Justice where the required registration statement is available for public inspection. Registration does not indicate approval of the contents of this material by the U.S. Government.

Mr. JENKINS. Thank you, Mr. Columbus.
Mr. Rossides.

STATEMENT OF EUGENE T. ROSSIDES, COUNSEL, ON BEHALF OF THE LIGA AGRICOLA INDUSTRIAL DE LA CANA DE AZUCAR, COSTA RICA

Mr. ROSSIDES. Thank you, Mr. Jenkins.

I will summarize my remarks to make a few points, and respond to some of what I consider outrageous comments of the Renewal Fuels Association.

The first being that the idea that the ethanol industry in Costa Rica is hostage to some comment that someone made at an agreement at 2 a.m. in the morning, on 30–60–75 percent indigenous content, is simply not responsible legislation.

You cannot bind people who are not there, No. 1. The domestic industry knows the situation. They know that they are not binding the CBI industry.

Mr. Chairman, a viable CBI ethanol industry is important to U.S. foreign policy interests. This is a point that Mr. Matsui made earlier that is essential and crucial to this whole discussion. It's not simply a question about the domestic U.S. ethanol industry worrying about keeping its monopoly.

Secondly, the recent ITC and GAO studies confirm that CBI ethanol has had no adverse effect on U.S. production. Mr. Chairman, I was involved in the dumping case brought against Brazil. For 2 years the domestic industry yelled about Brazilian ethanol. I had the responsibility to represent one of the Brazilian respondents. We won before the ITC on no injury, on a 4-to-1 vote, 2 or 3 years ago.

These reports also show, Mr. Chairman, that the U.S. producers cannot effectively supply demand in the coastal States. Recently our client, which is a trade association of 8,000 cane growers and 20-some odd mill owners in Costa Rica—shipped 1,600,000 gallons of ethanol to California.

Costa Rica's ethanol industry, as well as Jamaica's, as was developed in reliance on the original CBI requirements as Chairman Gibbons so clearly pointed out several times earlier.

I want to make another point. When we're throwing around percentages, Mr. Jenkins, we talk about 35-percent value-added. That is not to be compared with a requirement of 60-percent indigenous feedstock, or 30-percent indigenous feedstock. Thirty-percent indigenous feedstock equals over 50-percent value-added. Sixty-percent indigenous goes up to over 80 percent, and then 75 goes up commensurately.

Preventing the duty-free entry of substantially transformed ethanol will not help the development of grassroots CBI ethanol production. I do want to pick up on what my colleague Tim said. We have three facilities in Costa Rica. Two are full fermentation facilities adjacent to the sugar mills, and a third is a dehydration facility with a rectification column adjacent to it.

Lastly, Mr. Chairman, a reasonable compromise of this issue is possible. One of our problems for 3–4–5 years now, is finding someone in the domestic industry who will sit down and work out a reasonable compromise. It has not been possible.

It's very interesting, as someone asked earlier, whether a certain particular producer domestically had been invited to testify. It's obvious—and the comments, the by play between the Congressmen as to what and where we come out—it's there, a reasonable compromise.

They can take care of the domestic industry's concerns, and allow the CBI, which is so important to U.S. interests, to have this ethanol industry which is crucial. In Costa Rica it's important to their sugar ndustry. Why? Because it gives them the flexibility, during seasonal work and off season, to utilize the sugarcane for ethanol production. It gives them an enormous safety cap.

Mr. Chairman, I thank you for allowing us to testify. One other comment is that with me is Mr. Anthony Hogan, one of the real experts in this area, of Hogan and Company of Greenwich, Conn. who, for over 25 years or more has been the marketing agent for Costa Rican sugar, and in recent years, ethanol.

[The statement of Eugene T. Rossides follows:]

STATEMENT OF EUGENE T. ROSSIDES, COUNSEL

on behalf of the

LIGA AGRICOLA INDUSTRIAL DE LA CANA DE AZUCAR

Submitted for the Record to the
House Ways and Means Subcommittee on Trade

Re: April 25, 1989 Hearing on
Fuel Ethanol Imports from Caribbean Basin Initiative Countries

On behalf of our client, Liga Agicola Industrial de la Cana de Azucar ("LAICA"), the Costa Rican sugar and ethanol industry, we appreciate the opportunity to submit this statement for the hearing record. Our comments are directed to the following basic points:

(1) a viable CBI ethanol industry is important to the United States' foreign policy interests, as well as to Costa Rica and the rest of the CBI beneficiary countries; and

(2) the recent ITC and GAO CBI ethanol studies confirm our view that CBI ethanol has had no adverse effect on U.S. producers, and that additional CBI ethanol feedstock requirements would be economically uncalled for.

Costa Rica, its sugar and ethanol industry, as well as other intended beneficiaries of the Caribbean Basin Initiative (CBI) program, are attempting to retain duty-free CBI treatment for imports of their ethanol to the United States made after January 1, 1990. Duty-free entry into the U.S. is essential to preserving and developing the ethanol industry in Costa Rica as well as the rest of the region. In turn, ethanol production and exportation is key to the sugar industry in Costa Rica which is so important to that country's economic and social strength.

I. Background: The ethanol and sugar producers in Costa Rica comprise the Liga Agricola Industrial de la Cana de Azucar (LAICA) which is charged with the marketing of all Costa Rica's sugar and ethanol. LAICA is a non-profit corporation directed by six elected representatives of the industry's 21 sugar mills and more than 8,000 independent cane growers plus two appointed representatives of the Costa Rican Government. All mills are privately owned; three of them are cooperatives.

Among LAICA's major directives is the maintenance of a viable social as well as financial equilibrium among all of the sugar growers and mill owners. Accordingly, the proceeds of the anhydrous export sales are allocated among all the growers and owners on terms similar to those employed for the liquidation of white and raw sugar, and blackstrap molasses.

LAICA finances a major portion of Costa Rica's sugar crop. It handles the domestic distribution of the country's white sugar and molasses production through a wide ranging network of its own warehouses. And it arranges for and controls the export of all the country's raw sugar and anhydrous ethanol production through the bulk mechanical loading facility and tank terminal it owns and operates at Punta Morales.

Costa Rica was designated a CBI beneficiary country in November, 1983, among the first countries so designated by President Reagan.

II. Costa Rica's Ethanol Industry Was Developed In Reliance On the Original CBI Requirements

The regular requirements for duty-free entry under the CBI program are that (1) the merchandise must be substantially transformed in the CBI and (2) that local CBI-origin materials and processing total at least 35% of its value.

In 1985 LAICA requested and received a favorable ruling from the U.S. Customs Service that azeotropic distillation of non-CBI 190 proof ethyl alcohol to 199+ proof ethyl alcohol in Costa Rica would be such a "substantial transformation." Customs ruled, in response to LAICA's specific inquiry, as well as other parties' requests in 1984, that azeotropic distillation would qualify CBI ethanol imports for duty-free treatment under the CBI. See, e.g, Customs Service Decisions No. 553209HS (September 12, 1984) and No. 553849HS (November 19, 1985). The U.S. domestic ethanol industry's appeal of Customs' decision was denied by Customs on the merits and later by the Court of International Trade as moot.

In reliance on those rulings, LAICA began to enter into contracts to import hydrous ethanol to distill in the fermentation azeotropic distillation plant annexed to the raw sugar mill at CATSA. Completed in 1979, CATSA's first full season producing ethanol was 1985.

The U.S. Embassy in Costa Rica had also encouraged the Costa Rican sugar industry to diversify into ethanol as a source of hard currency and to stabilize employment threatened to the severe cutback of the U.S. sugar quota. In good faith reliance on the continuing viability of the CBI ethanol program, the sugar mill at Taboga in April 1985 contracted for the purchase and construction of a new 5 million dollar annexed fermentation and azeotropic distillation facility. The plant was constructed and began operations in 1986.

In further reliance, LAICA invested an additional 6 million dollars to construct an azeotropic distillation column and related facilities at its raw sugar terminal at Punta Morales. The plant was placed into operation in June, 1986.

It is therefore ironic that, after investing in its ethanol industry in the first place in reliance on U.S. law and policy, and with the encouragement of the U.S. Government, Costa Rica's private producers have had to contend with unfair and burdensome local feedstock requirements subsequently imposed by the United States in section 423 of the Tax Reform Act of 1986. These requirements alone were responsible for shutting down in 1988 the same ethanol plants which Costa Rica had invested in at the behest of the United States.

III. The GAO and ITC Ethanol Studies Confirm LAICA's View That Imports of CBI Ethanol Do Not Have An Adverse Effect on U.S. Ethanol Producers and that Additional Feedstock Requirements are Economically Uncalled For.

The 1986 Tax Reform Act singled out CBI ethanol and changed the rules on duty-free treatment for that merchandise alone. The 1986 Act basically required that in 1987 the local

19-676 0 - 89 - 5

CBI-origin hydrous portion of an imported blend would have to equal at least 30% of the blend's value. The requirement rose to 60% in 1988 and 75% thereafter.

After the 60% feedstock rule shut down the CBI ethanol producers in 1988, and CBI ethanol exports dried up, Congress in § 1910 of the 1988 trade law grandfathered a few CBI ethanol plants to permit them to return to the original 35% CBI value added formula. This exemption from the onerous requirements of the 1986 Tax Act expires at the end of 1989 and only permitted only a limited amount of blended CBI ethanol to enter the U.S. duty-free: 20 million gallons per grandfathered facility per year.

However, in Costa Rica, meeting the original 35% regular CBI value-added rule in practice required that at least 10% of the import's value is in CBI-origin hydrous ethanol. LAICA opposes any further indigenous requirement beyond this level. The 1986 Tax Act's 30% hydrous feedstock level required the equivalent of over 50% value-added under the regular CBI rule; the 60% requirement was equal to over 80% value-added, and the 75% requirement would have equalled over 90% value-added.

To resolve the conflict over CBI ethanol exports, Congress directed the General Accounting Office (GAO) and the International Trade Commission (ITC) to study the situation. These reports considered together provide a reasonable assessment of the matter and give no support to the U.S. ethanol producers' concerns about CBI ethanol.

GAO has found that, on the whole and under current conditions, CBI ethanol producers cannot be competitive with more than 10-30% local feedstock requirements. Fuel Ethanol, Imports from Caribbean Basin Initiative Countries, ["GAO Report"] at 3, 20-21. The ITC found that the 30% feedstock requirement would be unfeasible if gasoline prices were to fall. Ethyl Alcohol and Mixtures Thereof, ["ITC Report"] USITC Pub. No. 2161 at pages 5-10, 5-11 (February 1989). LAICA cannot be competitive if it had to include more than the 10% local feedstock which as a practical matter it includes when it meets the regular 35% value-added CBI test.

More important, though, are both studies' findings which support LAICA's view that the U.S. industry has not been harmed in any way by CBI ethanol. The GAO finding is worth quoting in its entirety:

> To date the largest amount of CBI fuel ethanol imports into the United States occurred in 1987, about 29 million gallons or about 3 percent in a total U.S. market of over 800 million gallons. Questionnaire responses from several U.S. ethanol producers to the International Trade Commission in the fall of 1988 indicated little impact to date from CBI imports. Only a few examples of price suppression or lost sales over the past years were provided.
>
> However, if Congress lowers the local feedstock requirement, future CBI ethanol imports could be considerably larger. As discussed in chapter 1, currently operating dehydration facilities in the Caribbean region have an estimated aggregate effective capacity of about 88 MGY. The amount of

> future CBI dehydration capacity that could affect the U.S. industry appears to range between 88 to 212 MGY

GAO Report at 29.

This means that CBI imports have had virtually no affect on U.S. producers in the past. Since CBI dehydration operating capacity stands at the bottom end of the range which could have any effect on the U.S. industry (88 MGY), there is also no foreseeable threat from the CBI industry. Id.

The ITC similarly found that imports of CBI ethanol "accounted for no more than 4 percent of total U.S. consumption during 1985-88." ITC Report at viii.

These minuscule import and penetration levels of CBI ethanol contradict as well the U.S. industry's concerns about the importation of EC wine ethanol for dehydration and blending. In the first place, the CBI's capacity to produce and export is not high enough to have any significant impact on the U.S. industry, particularly on Archer Daniels Midland, the dominant U.S. producer.

Secondly, much has been claimed and nothing proven about so-called "cheap" EC wine. As the ITC found, EC wine requires more intense, and therefore more expensive, processing to remove the various impurities. CBI producers believe that the wine is not an appropriate feedstock for use in the azeotropic distillation columns. ITC Report at p. 3-8.

Similarly, the GAO investigation found that

> Some [U.S. industry] observers have suggested that CBI companies have been able to obtain wet European ethanol at prices lower than those shown in table 2.1 [i.e., $.85-1.00/gal.] Information we reviewed showed that some purchases were made at lower prices but that most prices paid by firms during the past 2 years, after adjusting for alcoholic content and considering transportation costs, are consistent with the costs reported in table 2.1.

GAO Report at 19. So much for the U.S. industry's frequent claims about "cheap" EC wine bought by the CBI producers at prices much less than 50 cents/gal.

In addition, the GAO found that "industry analysts believe ethanol sales are far below their potential" in the U.S. because while ethanol represents about 17% of gasoline sales in the Midwest, it is only 3% on the West Coast, and 4% on the East Coast. GAO Report at 34. These two coasts are a market which CBI producers prefer to supply. According to the GAO's analysis of the data, only some 17% of U.S. domestic ethanol production was sold on the two coasts. Id. The ITC found five central U.S. states to account for almost 60% of all U.S. domestic shipments. High transportation costs from the Midwest U.S. plants to coastal states "ranged from 9-14% of the U.S. producers' delivered price, or 8-14 cents per gallon." ITC Report at p. 4-3.

These were some of the same factors which the ITC referred to in its total rejection of the U.S. ethanol industry's argument that it was being injured or threatened by dumped Brazilian ethanol. The ITC rightly voted 4-1 that there was no merit to the industry's concerns. See Certain Ethyl Alcohol from Brazil, USITC Pub. No. 1818 (March 1986).

The ITC's conclusions support LAICA's point that there can be no adverse effects from CBI ethanol when: (1) the U.S. market needs more CBI ethanol to supply demand, and (2) the U.S. producers cannot effectively supply demand in the coastal areas.

Given the utter lack of any harm to the U.S. industry from CBI ethanol, additional local CBI feedstock requirements above the 10% already implicit in the 35% value-added rule are economically uncalled for. Moreover, the ITC persuasively explained how single feedstock requirements are ineffective since they cannot account for all of the different variables which determine the competitiveness of CBI ethanol. ITC Report at p. 5-10.

IV./ Preventing the duty-free entry of "substantially transformed" ethanol will not help the development of grassroots CBI ethanol production.

It has been claimed that permitting the duty-free entry of "substantially transformed" ethanol merely forestalls the real development of the CBI ethanol industry. The claim is that the azeotropic distillation of non-CBI ethanol is only a "pass through" operation which engenders little investment or growth in the CBI - a result at odds with the goals of the CBERA program.

First, the azeotropic distillation is an expensive, complicated process as LAICA well knows. The Customs Service properly recognized this fact in studying the matter and issuing its ruling letters designating the "substantial transformation". As a matter of fact, the Punta Morales upgrading facility does represent a substantial investment and source of employment in the region.

The crucial factor in understanding why grassroots CBI production will be killed - not furthered - by cutting off the duty-free entry of CBI "substantially transformed" ethanol is the following: There is a substantial surplus of sugar cane in the CBI region, which has been the clear result of reduced U.S. sugar quotas and declining world prices. Moreover, displacement of sugar in the U.S. market has occurred due to the skyrocketing consumption of high fructose corn sugar (HFCS). This situation produced the need for Costa Rica to diversify into producing its own ethanol in the first place as well as blending it with "substantially transformed" non-CBI ethanol.

However, there is an obvious limit on producing wholly indigenous CBI ethanol from sugar. Contrary to the allegations of those opposing dehydration of non-CBI product, the duty-free entry of blended ethanol into the U.S. does not hinder the production and export of wholly indigenous CBI ethanol. The duty-free entry makes it possible to produce and export indigenous ethanol even at times when the opportunity costs for sugar are at a higher level than the actual sales price of a gallon of ethanol.

What the critics of CBI ethanol exports ignore is that the newly diversified raw sugar mills in Costa Rica, El Salvador, Guatemala, Haiti, and Jamaica now have the option to produce ethanol or sugar, whichever yields a better return. (The U.S. corn wet millers will recognize this situation as similar to one they faced last summer when they chose to produce more highly profitable HFCS, to the detriment of their ethanol customers.)

Therefore, basically the only ethanol coming into the United States from the region, under present and foreseeable circumstances, is a blend of indigenous and "substantially transformed" ethanol. The price of exporting only ethanol wholly grown in Costa Rica - or elsewhere in the region - just does not permit a return otherwise in the U.S. market.

An important related finding was made by the ITC in its study. The ITC discovered that increasing the indigenous feedstock requirement from 30 to 60% in 1988, under the imposition of the Tax Reform Act of 1986, did nothing to foster or increase employment in the CBI ethanol industry. Specifically, the increase in workers would have primarily been a shifting or reallocation of existing sugar cane workers to ethanol. ITC Report at pp. ix and 5-6.

V. A Viable Ethanol Industry Is Important to Costa Rica and the CBI Region and, Therefore, to U.S. Foreign Policy Interests As Well.

The Costa Rican sugar industry decided to diversify from sugar into ethanol, in order to stabilize its income, cane production, and employment, as well as to provide the sugar cane industry with flexibility to maximize its net returns.

But more broadly speaking, the industry has tried to remain a vigorous agricultural, economic and social force in Costa Rica. This point is significant when consideration is given to the production of sugar cane in the highly populous central plateau, where the planting and harvesting of sugar cane is tightly interwoven on a year-round basis with the production of coffee, the country's largest employer and largest foreign exchange earner.

In the period 1975-1981, before the reintroduction of U.S. sugar quotas, Costa Rica's annual exports of sugar to the United States averaged in excess of 82,000 short tons. During the five year period (1983/84 through 1987/88) Costa Rica saw its U.S. quota reduced from 62,000 short tons to 13,000 short tons. During the same five year period, annual world market sugar prices averaged 4 to 8.5 cents per pound, compared to Costa Rican production costs of approximately 12 to 13 cents a pound.

Costa Rica's democratic roots and values are nurtured by the success of its numerous small land owners. However, Costa Rica is also a country which, in the 1980's, has been increasingly inundated by political and economic refugees from neighboring Central American countries, thereby expanding its population by more than ten percent and testing to its very limits the country's social welfare structure.

It was in the context of growing domestic social problems and declining U.S. sugar quotas and world market prices in 1984-85 that the Costa Rican sugar industry, placing its reliance in the Caribbean Basin Initiative and U.S. Customs Service rulings on motor fuel ethanol, revitalized one and constructed two new ethanol facilities. This represented a total investment cost in excess of 24 million dollars.

All the proceeds from the sale of Costa Rican ethanol are kept in the country, commingled with the proceeds from sugar and distributed according to formula among all Costa Rican private sugar mills and more than 8,000 cane growers.

As a result of Costa Rica's partial diversification of its sugar production into ethanol, the following benefits accrue to the industry:

1. Some 700,000 metric tons of sugar cane will produce ethanol at an enhanced value instead of surplus world market raw sugar.

2. It will use all domestically produced surplus blackstrap molasses for conversion into ethanol at an enhanced value;

3. It will prolong the employment cycle at the two annexed distilleries by one to three months, beyond the normal three-to-four-month cycle.

4. It will provide year-round employment at the Punta Morales azeotropic distillation column.

This strengthening and diversification of Costa Rica's agricultural economy is precisely the type of development envisioned by the CBI program. Part of the basic rationale for the CBI in the first place was to strengthen the Caribbean Basin economically so that it would, in turn, be strong and free politically.

One of the hallmarks of U.S. foreign policy towards Central and Latin America since the Good Neighbor Policy, through the Alliance for Progress, and up to the CBI program today, is that economic strength in the countries to the South means political strength and stability for them as well.

Social and political unrest in the CBI beneficiary countries, whether imported from outside the region or from other countries within the region, will most likely occur when the economic structure in that region is weak and vulnerable. A working, healthy economy will withstand elements seeking to foment political unrest.

The United States has a most significant stake in the security and stability of the countries in the Caribbean Basin. Some of these countries are threatened with the spread of terrorism, political instability, or outright revolution. It is so clearly in the United States' national interest to prevent or reduce these threats. If the security of its close neighbors is compromised, the United States also suffers.

Large numbers of refugees have been drawn to Costa Rica from other countries in Central American because of existing instability elsewhere in that region. Costa Rica, with no standing army, remains a proud and secure democracy - and rightly so. Costa Rica not only is providing a form of a safety valve in the region, but, as shown by the granting of the Nobel Peace Prize to its President, Oscar Arias, is able to play a useful, moderating and affirmative role in regional affairs.

Maintaining a vital ethanol industry in Costa Rica, with all of its benefits to the economy and society of that country, not only is key to stabilizing that country and Central America, but also to protecting the United States' national interest there.

VI. A Reasonable Compromise of this Issue Is Possible

It is LAICA's position that this protracted dispute over CBI ethanol can be reasonably resolved. The GAO has proposed three options for dealing with this issue.

The first would be to set a feedstock requirement in the range of 10-25% in addition to the 35% value-added rule. LAICA would become uncompetitive with more than 10%.

The second would be to eliminate all local feedstock requirements and maintain the regular 35% value-added rule. The GAO's proposal would allow all presently grandfathered plants to avoid any feedstock requirement as is the case with all other CBI duty-free exports to the U.S. This is reasonable since, at least for Costa Rica, its industry must employ around 10% local feedstock.

Option three would continue the grandfather provision of § 1910 of the 1988 trade law and permit presently eligible plants to export duty-free within the 20 million gallon cap per facility each year, by meeting the 35% value-added test. The GAO proposes that exports above that limit would have to meet some feedstock requirement, say 30%.

LAICA proposes that any local feedstock requirement be expressed in terms of volume, not value. This would be much easier to ensure compliance with the requirement and would make cost calculations unnecessary in determining feedstock levels.

Given the lack of any harm or threat to the U.S. industry, and the reasonableness of much of the GAO's proposals, LAICA believes that a compromise which would address and take into account the real needs of both the U.S. and CBI producers is possible. What is necessary is to identify someone with authority in the domestic industry with whom such a compromise could be reached.

Mr. JENKINS. Thank you.
Mr. Southerland.

STATEMENT OF JAMES SOUTHERLAND, SECRETARY-TREASURER, VIAG FUELS, INC., ST. CROIX, VI

Mr. SOUTHERLAND. Good afternoon. I'm Jim Southerland of VIAG Fuels of the U.S. Virgin Islands.

I really feel unique in this situation today. We have a ethanol plant that has produced ethanol under feedstock requirement. I thought for a while we probably were the only one who had accomplished this; and I'm informed that I—my memory—my knowledge, is quite limited—that's not quite true.

I would like to at least tell you something about what's it like to operate under a feedstock requirement. I won't try to tell you how a product of the United States got labeled as a CBI product. That happened late Saturday. But, nevertheless, it did. And we are.

The way I see the problem we have in operating Caribbean ethanol facilities right now, is really Congress getting its fingers entangled in the strings of an economic yo-yo. It's up, it's down, it's up, it's down. What we're really here today to try to do, is to find a way to stop the yo-yo.

The initial investment in our plant was made in 1985, this was before the 1986 operation. Customs agreed that everything coming from that plant, should enter under general headnote 3a, of the tariff schedule, which covers manufactured goods from the Virgin Islands. That was fine.

Then, of course, now the yo-yo got yanked back up by the 1986 Tax Reform Act. Then the CBI did quite well in the omnibus trade bill of last year, and it came back down, and we could operate all the way to the end of 1989. We could see that far down the road.

I heard some comment today about the low cost of investments and this sort of things. I really didn't know what they were talking about. Because, in our plant alone, the original investment was over $2 million in equipment and construction, we have expended that much more in money just trying to stay in operation. Stay in business without producing these years.

In 1987 when we were producing with a 30-percent feedstock requirement, we were paying $4 a gallon for CBI feedstock. Now, let me say right here—we were not being ripped off. That's just about what it costs the Virgin Islands rum industry to produce that 1 gallon of feedstock for us.

At that time, ethanol was selling for $1.04 a gallon. That was pretty marginal operation. As a matter of fact, we broke even at first, then we started losing money. In November we were facing a 60-percent requirement in 1988 which was totally impossible. So we closed the plant, and we have not reopened simply because—first of all, we had to get some operating capital in. That required about 3 months.

Then, guess what, I today kept hearing about this great lake of European wine alcohol. Well, let me tell you about that lake. I can't find it. I have been unable to get 1 gallon of European alcohol into the U.S. Virgin Islands.

At one time we got our order accepted from Italy. We put up our letter of credit. What happened a week later, we get notice that—"Well, we're going to have to give you permission to withdraw your letter of credit, simply because we do not have the alcohol."

As you know right now the wine commission is in the process of making its allocations. From the conversations we've had with our representatives there it looks reasonable that we will get some of the allocation when it's made. They are indicating that this will probably be something in May.

May I remind you that a bureaucracy made up of one government is one thing, but a bureaucracy made up of several governments is another thing. I'm expecting it probably, realistically, in June or so. I don't think it'll be before that.

We going to need more operating capital. How do you go out and raise operating capital when you can only say—well we're sure that we can operate all the way till the end of 1989. It's not easy. As a matter of fact, it's pretty close to impossible. I think if I could do that, I could probably sell some other things that we might need to sell.

Before I go much further, let me just say that we have some needs, and the needs are quite simple. What we really need is laws, rules, and regulations that provide for stable conditions and no more yo-yo effect. We need equality, we need fairness, and most of all we need justice.

I don't think there's any one member of this subcommittee that will argue against any of those. It's simple to achieve these. All we need is to go back to the conditions under which the investment was made. That's the pre-1986 condition. For the U.S. Virgin Islands, of course, at that point it was headnote 3(a), and I believe such recommendations have been made previously to this subcommittee.

However, we are agreeable to whatever can be worked out. But, something has to be done to provide some stability, and it must be fair and equitable. It is not equitable to the people of the U.S. Virgin Islands to be told to do the best you can, and to increase your economy, to upgrade your business acumen, your business base, and then each time you do it—under the rules that exist—then for Congress to throw in some rule that somehow negates everything you've already tried to achieve. This is what has happened in this case.

It also might interest you and the corn growers, particularly, to know. In the U.S. Virgin Islands we have a great need for grain and feed. We've got a dairy operation down there that provides whole milk only for the island of St. Croix, simply because we cannot get sufficient feed in there to feed the cows.

As a result, VIAG has on the drawing board, and has plans, and has everything in place, so at the moment we start generating a cash flow with the ethanol production, to build a corn storage and grain fermentation unit.

I will not sit here and tell you that in the U.S. Virgin Islands where we have no natural resources of any kind, that can support any ethanol, we're going to go to 100 percent fermentation. I don't believe it's possible, so I will not even suggest that.

I will tell you that the grain fermentation and the use of the grain is very important to us. As a matter of fact, it will allow our grain farmers there to all of a sudden have a market, which they do not have now. This is another important off shoot which we have.

As a result, I urge this subcommittee, the entire Committee on Ways and Means, and both the House and the Senate, to take a very decisive step toward clear air for the United States. Take a step toward equality, fairness, and justice for the CBI fuel ethanol producers. Stop the yo-yo. Return us to stable conditions.

[The statement of James Southerland follows:]

Jim Southerland, VIAG Fuels, Inc.
Statement to the Subcommittee on Trade
April 25, 1989

Good afternoon Mr. Chairman, Subcommittee members, staff!

I am Jim Southerland, Secretary/Treasurer of VIAG Fuels, Inc. St. Croix, United States Virgin Islands. VIAG Fuels is the owner and operator of an ethanol plant. Our plant, to the best of my knowledge, is the only ethanol facility in the Caribbean to have operated under a feedstock requirement. I believe this makes us unique and provides a factual base from which to make comments to this Subcommittee's hearing on "FUEL ETHANOL IMPORTS FROM CARIBBEAN BASIN INITIATIVE COUNTRIES."

How ethanol from the United States Virgin Islands became a Caribbean Basin Initiative (CBI) product is somewhat complicated and represents a portion of the basic problem we have before us. In fact, you should have listened as I tried to explain to GAO officials doing the CBI ethanol study; I'm not sure they ever fully understood.

The problems we face are largely a product of Congress' fingers becoming enmeshed in the string of an economic yo-yo. It's up, it's down, it's up, then it's down. And we are here today trying to finally stop this yo-yo.

The initial investment in our plant on St. Croix was made in 1985. It was agreed that ethanol produced by this investment would enter the U.S. market under General Headnote 3(a) of the Tariff Schedule of the United States (TSUS). These were the rules and conditions under which this investment was made.

Then the yo-yo was yanked up by the enactment of the 1986 Tax Reform legislation. This act jumped in and set feedstock requirements for ethanol produced in the U.S. Virgin Islands and made this U.S. Territory's ethanol a CBI product--all this after the investment had been made and despite assurances that U.S. Virgin Islands' ethanol would enter the mainland under General Headnote 3(a) TSUS.

Next, Congress passed the Omnibus Trade Bill and the yo-yo came back down. Now we could operate until December 31, 1989 without a CBI feedstock requirement. At the same time, GAO and the International Trade Commission (ITC) were mandated to do a study on the possible damage to U.S. grain growers which might be inflicted by this no feedstock requirement. We contended there would be no adverse affect.

Guess what? Even a cursory look at the reports supports our position. The question is, where do we go from here?

Before making recommendations on the direction we should pursue, let's look at VIAG's operations in 1987 with a 30% CBI feedstock requirement.

Our plant purchased its CBI feedstock from Virgin Islands Rum Industries. The cost was $4.00 per gallon. And let me say right here, it cost just about $4.00 to produce. Ethanol was selling for around $1.04 per gallon. This was not a profit making operation for our plant. It was almost a break even situation at first and then the losses hit. In November 1987 we were staring at a 60% CBI feedstock requirement beginning in January 1988. This was an impossible task; the yo-yo was just too high to reach.
This yank of the yo-yo was also after the investment: our plant was closed. There was no other choice.

With operating capital being depleted each day the only ray of hope was in the Omnibus Trade bill in 1988. Guess what? Congress sent the yo-yo down to the rescue again: we were given until the end of 1989 to operate without a feedstock requirement. Operating capital had to be pulled into the coffers. This required about three months. Then, VIAG was unable to secure feedstock from any source. At one point we were told that Italy had accepted our order. We put our letter of credit in place and after about one week the word came. There is no hydrous alcohol available.

The European Common Market Wine Commission is at present in the process of making its allocations. The prospects for VIAG securing some of this feedstock appears very good. We are told that it should be released sometime after May first.

Meantime, operating capital has and is slipping away. We have no assurance we will be able to operate after December 31, 1989. Try to raise capital under these conditions. This uncertainty is a great inhibitor even though almost every day we see an increase in demand for fuel ethanol in the U.S.

This is the VIAG saga of operating under a feedstock mandate which is unreasonable while at the same time the operating climate created by our government has imitated all the movements of a yo-yo.

Now, what do we ethanol producers in the United States Virgin Islands need?

We need laws, rules and regulations that provide stable conditions with no more yo-yo effects. We need equality, fairness and most of all justice. I do not believe there is one member of this Subcommittee who will argue against these simple needs; I do not believe any Congressman or Senator would take such a stand.

Achieving these conditions is not difficult. It only requires that we return to the pre 1986 conditions for all plants who made their investment prior to the 1986 Tax Reform Act. I have previously submitted to this Subcommittee a recommendation to this effect for the fuel ethanol producers in the United States Virgin Islands

Each of you, I'm sure has a copy of the GAO report dated February 1989 and titled "Fuel Ethanol." This report makes it very clear that imports from the CBI--including the U.S. Virgin Islands--will not damage the domestic grain industry.

It might interest you and the Corn Growers Association to know that as soon as VIAG Fuels can generate a cash flow by producing fuel ethanol, we will begin building our corn storage facilities and grain fermentation units.

We have a strong need for grain and feed in the Territory. Building this facility will make high quality feed available to the dairy farmers, the hog growers, the poultry producers etc. At the present all feed is shipped in and the cost inhibits the use of quality feed which would produce good quality and quantity for our farmers.

You must know that more states are mandating the use of oxygenated fuel, General Motors has moved in that direction: demand for at least the next few years will exceed all our combined capacity to produce.

I urge this Subcommittee, the Committee on Ways and Means, the House and Senate to take a decisive step toward clean air. Take a step toward equality, fairness and justice for the CBI fuel ethanol producers. Stop the yo-yo. Return us to the conditions under which the investments were made.

I thank the Chairman and committee members for taking its valuable and pressured time to hear my presentation.

-0-

Mr. JENKINS. Thank you. And I want to thank the entire panel. Let me ask a couple of questions. I was not here for the earlier testimony.

Mr. Southerland, in your statement that we need to go back to the pre-1986 situation, would that leave you in a better position vis-a-vis the other people in the Caribbean?

Mr. SOUTHERLAND. I would think not. I will tell you why very quickly.

We have OSHA, we have EPA, we have a minimum wage higher than you have on the mainland. No, it would not leave us in a better position. As a matter of fact, it would probably leave us in a less competitive position.

Mr JENKINS. Well, are you supportive of the CBI bill?

Mr. SOUTHERLAND. Absolutely.

Mr. JENKINS. Mr. Columbus, I want to ask you one question.

Percentage wise, how much of your production has been from wine, European wine? Money wise or any other ratio.

Mr. COLUMBUS. I can tell you the value of the 1987. It was approximately 70 percent, 70. In 1987, Petrojam which did not have a grandfather to the 1986 act, produced and sold I think somewhere in between 8 and 10 million gallons of ethanol in the United States. And we met the 30 percent domestic feedstock.

In terms of volume, I don't know what those numbers are, Mr. Jenkins. I would be happy to provide them for the record.

In 1988, the company did not operate because, in 1988, it would have been subject to 60 percent. That was infeasible.

In 1989, we have started up. In fact, I think we made our first shipment of about 700 or 800,000 gallons this spring.

Mr. JENKINS. Have you been able to get an allocation of wine?

Mr. COLUMBUS. To the best of my knowledge, no. We anticipate that some will be available to us.

Mr. JENKINS. Who is getting all the wine?

Mr. COLUMBUS. My understanding is, and Mr. Hogan can probably speak to that better than I, but my understanding is that right now the EC is in the process of determining not only who is going to get it but how much they're going to release. Is that right, Tony?

Mr. HOGAN. Yes.

Mr. ROSSIDES. Mr. Hogan has not been able to buy EC wine lake since last September. Now, the EC has put out some regulations or rules are in the process, as Mr. Southerland said, of determining the amount.

But if I may follow on the question you asked Mr. Columbus. In Costa Rica, for LAICA, which is the trade association I mentioned representing 8,000 cane growers and 21 some odd mills, it was approximately the same for 1987—a 70-30 ratio.

Mr. JENKINS. A lot of the committee members had tremendous concern about subsidized wine being the predominant feedstock for the fuel. And as I understand the testimony, every company is having difficulty getting it.

Who is getting the wine?

Mr. HOGAN. It's been hard to come by. No one at the present time. I think Tropicana, because it had a contract that it made back in 1986, I think it has still been able to draw out a small

amount of wine under that former contract. But no new contracts have been made.

Mr. JENKINS. And this wine issue, it is just not a real issue?

Mr. HOGAN. I think that the wine is there, but the EEC provision, I understand, is very much aware of not wanting to get themselves involved with the problems of trade with the United States. And they are very cautious as to where they want to sell that wine.

There are opportunities to sell it to Brazil. Brazil is having problems with their great demand for alcohol for the automobiles that they have. And they haven't had that good a sugar crop. So they are in demand of alcohol. And you have a tremendous demand throughout the world for chemicals, including ethanol, for industrial purposes. And that brings the higher price than what we can afford to pay for fuel ethanol upgrading in the CBI. So we are at the bottom of the priorities of where the EEC would like to sell its wine. But they don't want us to buy it and then have it come back in and compete with other markets of theirs. So they are very cautious as to who and when and where. And they are taking a long time to come up with those regulations, and they haven't issued them yet.

Mr. ROSSIDES. Well, it is, in effect, largely a myth, Mr. Jenkins, on that count. But on the other count, as chairman—

Mr. JENKINS. Well, the thing that I am trying to reconcile, and I am no expert in this field, if in fact it's a myth and, at the same time, you must have it in order to profit, the idea of a wine lake, people coming in and making a lot of profits, and non-indigenous people doing it, that's largely a myth.

Mr. ROSSIDES. There is a supply there. It has been used. It will be used in the future to some degree for the CBI. But the amounts will be absolutely limited. You are not having some mountainous wine lake available to just pour on the faucet.

But, second, the comments that the chairman made earlier that the CBI concept was 35-percent value-added means it doesn't matter what the product is. It's 35-percent value-added. If it's value added in the CBI, you made the determination in setting up the CBI that this would be economically helpful and, therefore, that was doable.

But, now, the domestic industry wanted the added attraction of higher indigenous requirements. They focused on the problem of one company that they said they had negotiations with. And I feel quite strongly that in those kind of negotiations, the people on both sides should know that they couldn't bind a company, such as Petrojam, or our several companies in Costa Rica.

But our clients in Costa Rica are 8,000 people. Any end profits are shared in Costa Rica, we're talking about, 8,000 members of the trade association. They're cane growers. Any profits that come from sugar or ethanol go into that pot and are distributed pro rata to the sugar growers by the proportion that they put the sugar in. I think it is one of the finest programs around in the Caribbean. And the fact is that ethanol gives you flexibility.

Just like the corn growers here and the producers here in the summertime, they produce high fructose because they can make a better profit.

Ours is a little different. We have the flexibility of ethanol which gives us a floor, so it's a safety valve to tied the price of sugar.

Mr. JENKINS. Mr. Columbus.

Mr. COLUMBUS. Thank you, Mr. Jenkins.

First of all, Mr. Kirk asked me to point out for the record that Tropicana's contract expires this spring, one contract, and so they'll be in the same boat as everybody else.

But when you talk about this great concern of subsidized wine, I heard several members of the subcommittee today talk about their desire to see employment opportunities developed in the Caribbean Basin. And that the only way that is going to happen is with some enormously high requirement for domestic content.

The first thing I have to tell you is that that is going to take time. I mean there is no question that it's in Petrojam's interest, and part of that is its unique corporate structure. It's for profit, but it's for the benefit of the people of Jamaica to get to 100 percent.

The U.S. ethanol industry has taken a long time to get where it is today. The reason a company like Petrojam, and I speak only for my client, uses the wine ethanol at all, is not because it wants to, it's because the reality of the U.S. market is that if it doesn't blend down its cost of feedstock, it will not be able to sell the product in the end market at a price which will allow it to recover those costs.

Mr. JENKINS. In effect, you're saying that you have to have the subsidized wine in order to compete in the U.S. market.

Mr. COLUMBUS. Mr. Jenkins, I wouldn't care if it were subsidized wine or other feedstock in ethanol. There is going to have to be some feedstock, at least for the short term foreseeable. When I say short term, I am talking 5 years out foreseeable future in order to blend that sort of thing down.

And when I say 5 years, we are probably talking 10 years more before we get to 100 percent. It is in the interest of all of these people to get there.

My client has a project that's dedicated to making fuel ethanol. That's what it does. And we want to be there on our own. But the fact is the numbers don't fit, and if the numbers don't fit, the whole thing is illusory.

Mr. ROSSIDES. I want to further comment on this wine lake, Mr. Chairman. Our client, LAICA, has never purchased for less than 60 cents. You hear talk about 25 cents, 30 cents, 15—never less than 60 cents, and then, it has to be run through the dehydration facility twice because of the impurities. And that is why they put up the——

Mr. JENKINS. That is what you call double and twisted.

Mr. ROSSIDES. Double and twisted.

Mr. JENKINS. That is the way we used to make white liquor back in the mountains. [Laughter.]

I understand the terminology.

Chairman GIBBONS [presiding]. I am sorry I had to excuse myself to attend another meeting.

Now, let me see. You represent who?

Mr. SOUTHERLAND. VIAG Fuels, U.S. Virgin Islands.

Chairman GIBBONS. And you represent?

Mr. COLUMBUS. Petrojam.

Chairman GIBBONS. Petrojam. That is Jamaica?

Mr. COLUMBUS. Correct.

Chairman GIBBONS. And you represent?

Mr. ROSSIDES. LAICA, which is the Liga Agricola Industrial De La Cana De Azucar in Costa Rica, the Costa Rican three facilities, two of which are full fermentation and one is a dehydration. And Mr. Hogan is their marketing agent for 25 years and probably one of the most knowledgeable men in the sugar and ethanol business in this country. His company is in Connecticut. He has been the long-time marketer for Costa Rican sugar and ethanol.

Chairman GIBBONS. We already had the Tropicana folks in here. Do you all represent all the rest of them? Are there some missing people?

Mr. ROSSIDES. There are two missing people who do not have active facilities but have the right under the grandfathering clause, if they build their facilities. I think they were mentioned here by somebody, Chemfuels and Allied. Other than that, I think we——

Chairman GIBBONS. Where were they supposed to go?

Mr. SOUTHERLAND. Allied in the Bahamas and Chemfuels in the U.S. Virgin Islands.

Mr. ROSSIDES. And there is someone here who represents the Virgin Islands.

Chairman GIBBONS. OK. To summarize your testimony as I heard it, there is not, as far as you are concerned, a big pool of wine that is available to purchase, and you do not know how much you are going to get. The price is around 60 or 50 cents a gallon——

Mr. ROSSIDES. No, we have never purchased for less than the total cost to us of 60 cents from Costa Rica. I do not know about the others.

Mr. COLUMBUS. Mr. Chairman, I can speak for Petrojam. Petrojam has not improved on that. The last purchases, which were last fall, were all in the 60- to 70-cent range, I believe.

Chairman GIBBONS. The same for you?

Mr. SOUTHERLAND. Yes, that is about the price.

Chairman GIBBONS. And do you expect to know in what month when you can get some more?

Mr. SOUTHERLAND. Our representatives have told us that some time in May, after the 1st of May.

Chairman GIBBONS. It will probably be in June.

Mr. SOUTHERLAND. Yes. You understand why I have said that; I think I have explained.

Chairman GIBBONS. That is the same for all of you. You could all survive on the 35 percent?

Mr. SOUTHERLAND. Oh, yes. Original CBI? Absolutely.

Chairman GIBBONS. Original CBI. What would it take for you to survive? I don't know where the votes are. I guess we have to figure out how you can survive. How could you survive?

Mr. ROSSIDES. I would say one thing. I would say where we cannot survive I think is clear, Mr. Chairman, that from the studies, obviously 60 and 75 percent are not feasible. And keep in mind, as you probably know, Mr. Chairman, the 60-percent requirement of indigenous equals over 80 percent value-added.

I think that the GAO study talked about this 10-to-25 and 30-percent indigenous as part of the 35 percent value-added. I think anything over 30 percent—and we are not saying 30 percent is doable.

I am just saying that clearly anything over that, you are putting them at an enormous disadvantage. But Mr. Hogan might want to comment a little further.

Mr. HOGAN. No.

Mr. SOUTHERLAND. I would say that, as far as we are concerned, in the Virgin Islands, anything over 30 percent is absolutely impossible. We are talking about feedstock now.

Chairman GIBBONS. That is right.

Mr. SOUTHERLAND. As a matter of fact, we would have to think long and hard and be sure the market is going to stay where it is today in both the gasoline and the ethanol, before we would be real comfortable with making the additional investment that we must make to go into the future.

Mr. ROSSIDES. In our present production, Mr. Chairman, we by definition use approximately 10 percent indigenous within the 35-percent value. We use that now.

Chairman GIBBONS. All right. Well, thank you, gentlemen. I appreciate it very much.

Mr. ROSSIDES. Mr. Chairman, we thank you for holding this hearing.

Mr. SOUTHERLAND. Thank you, Mr. Chairman.

Mr. COLUMBUS. Thank you, Mr. Chairman.

Chairman GIBBONS. Next we have the National Corn Growers Association, the Corn Coalition, and the Minnesota Ethanol Commission.

Mr. Wentworth.

STATEMENT OF STEVEN WENTWORTH, PRESIDENT, NATIONAL CORN GROWERS ASSOCIATION

Mr. WENTWORTH. Thank you, Mr. Chairman.

Our organization, the National Corn Growers Association, is made up of more than 22,000 members in 22 States that grow about 90 percent of the corn in the United States. I have submitted my formal statement for the record, so I will take just a few minutes to summarize it.

The primary goal of the National Corn Growers Association is to enhance and expand the use, marketing, and efficient production of corn. One of the most exciting new market developments for our corn growers in recent years has been the growth of the ethanol production in the United States. In fact, we expect more than 360 million bushels of corn will be used to make ethanol here this year. Eventually, we hope the domestic ethanol industry will use more than a billion bushels of corn every year.

The National Corn Growers Association's interest in ethanol spans more than a decade and has placed us on the cutting edge of every major market development, trade, and environmental issue that challenges the producers and marketers of ethanol.

It is that interest in the U.S. ethanol production that brings me here today, instead of planting corn like I should be. Specifically, the National Corn Growers Association is concerned about the danger that our domestic ethanol industry faces from ethanol imports from the Caribbean Basin Initiative countries.

Please do not misunderstand me. Our group is fully supportive of a full fermentation ethanol industry in the Caribbean, using feedstocks grown in that region, and agrees the Caribbean ethanol produced from indigenous feedstocks should be exempt from the United States ethanol import duty. Such a full fermentation industry would help the Caribbean nations in the same way that it helps us here in the United States: by creating new, value-added markets for our agricultural production, increasing the prices farmers get for their commodities, and improving the balance of trade.

We are four square in favor of those goals. However, we are strongly opposed to allowing Caribbean Basin Initiative to be used to transship European Community wine alcohol through the Caribbean simply to escape the U.S. duty on imported ethanol. That is no idle concern.

Over the past 4 years, the National Corn Growers Association has worked to stop a number of schemes designed to ship fuel ethanol duty-free into the United States. Under these duty circumvention schemes, ethanol importers not only escape the U.S. duty at the border, but they also took full advantage of the U.S. excise tax break designed specifically to help establish our domestic ethanol industry.

Importers and traders took advantage of several loopholes in the tariff laws to bring in millions of gallons of ethanol into the U.S. market without paying the duties on those imports. Foreign ethanol was blended with benzene, toluene, and escaped the duty as a fuel additive. Ethanol was blended with gasoline and assessed only the gasoline import duty.

The importers use the generalized system of preference countries to bring ethanol mixed with xylenes into the United States. Through the 1986 Tax Reform Act written in the Ways and Means Committee and various administrative steps, these duty circumvention steps have been successfully shut down. While these loopholes are closed now, the domestic ethanol industry paid a serious price in terms of lost markets in Florida, North Carolina, and elsewhere. We want to make sure that does not happen again.

Now, let us be clear about what EC wine alcohol is. It is already highly distilled and marketed at more than 180 proof. As a result, all the Caribbean Basin dehydrators have to do is use a relatively simple dehydrating facility to remove about 5 percent of the water in each gallon.

Here in the United States, we use corn to make ethanol. What these dehydrators do in the Caribbean essentially is to use ethanol to make ethanol. It is that simple. Those dehydration companies are the only people who gain from the duty-free treatment for transshipped EC wine alcohol, aside from the Europeans, that is.

U.S. farmers lose because wine alcohol displaces domestically produced alcohol made from corn. Caribbean people lose, too, because those simple dehydrating facilities do not use Caribbean-produced sugar cane or other crops to manufacture alcohol. Those dehydrating plans employ far fewer people than full fermentation facilities. Creating economic development opportunities and meaningful employment is what the Caribbean Basic Initiative is all about.

Mr. Chairman, if Congress takes no other action, beginning next year 75 percent of the value of every gallon of ethanol imported

into the United States must come from locally produced feedstocks if it is to get duty-free treatment. We ask that you not decrease the home-grown requirement in the new CBI legislation.

These importers have asked for and received several extensions of their duty-free status in the past few years. Now it is time to put their extensions to an end.

Thank you very much.

[The statement of Mr. Wentworth follows:]

Statement for the Trade Subcommittee of the House Ways and Means Committee

on ethanol importation from Caribbean Basin Initiative countries

Steven Wentworth
President
National Corn Growers Association

April 25, 1989

My name is Steven Wentworth and I am President of the National Corn Growers Association. I am also a farmer, and grow corn and soybeans on a family farm located in Oreana, Illinois.

I am testifying on behalf of the National Corn Growers Association to explain to the subcommittee the origins and intent of the federal commitment to the domestic ethanol industry, the importance of this federal commitment to domestic agricultural interests, the potential abuse of this program by those who would transship European wine alcohol through Caribbean countries duty-free to the United States, and the devastating impact this abuse would have on domestic agriculture and related interests.

Let me briefly describe the National Corn Growers Association and its interest in ethanol. The National Corn Growers Association is a nonprofit, nonpartisan organization, which consists of approximately 22,000 voluntary members, 22 affiliated state membership organizations and 13 mandatory checkoff states and represents approximately 90% of the production of the nation's estimated 1.3 million corn farmers. The National Corn Growers Association also has 72 supporting members from all sectors of the corn industry, including domestic ethanol producers, as well as input suppliers, marketers, rural banks, food processors, users and exporters.

The goal of the National Corn Growers Association is to enhance and expand the use, marketing and efficient production of corn. In an otherwise bleak environment for corn growers, the National Corn Growers Association recognizes that the demand for corn created by domestic ethanol production -- currently 350 million bushels per year -- is the most promising development in the corn market in recent years. As I will discuss in a moment, in a very real sense the domestic ethanol industry is <u>our</u> industry.

Accordingly, the National Corn Growers Association has been a pioneer and leader in the development of this industry. Since 1978, the National Corn Growers Association has been a leader in the legislative effort and has invested well over 1 million dollars in money, labor and materials in marketing efforts to achieve an expanded market for domestic ethanol production. The National Corn Growers Association has established as its goal a demand for corn from domestic ethanol production of 1.2 billion bushels by 1993.

The National Corn Growers Association has also led the fight against duty-free imports that imperil the continued expansion and the very existence of the domestic ethanol industry. Most significantly for these proceedings, the National Corn Growers Association led the challenge by domestic interests against the United States Customs Service's ruling that ethanol merely dehydrated in the Caribbean qualified for duty free treatment under the Carribean Basin Economic Recovery Act ("CBERA"). Before the Corn Growers' legal challenge of this ruling was resolved, Congress enacted the Tax Reform Act of 1986, which represented, in Congress' own words, "disapprov(al) of the U.S. Customs Service rulings,"*/ and which at least partially closed the loophole created by the Service's ruling. The National Corn Growers Association also led successful challenges by domestic interests to two other loopholes in the 60-cent special duty: (1) rulings by the Customs Service that ethanol mixed with small amounts of toluene could be imported without payment of the duty, and (2) the determination by Customs that ethanol mixed with xylenes containing ethylbenzene were entitled to duty-free treatment. Both loopholes were immediately closed, in large part as a result of the National Corn Growers Associations' efforts.

Unfortunately, the ethanol toluene loophole was not closed until 44 million gallons of this blend were imported duty free. The impact of these imports on the domestic industry is a lesson that will not soon be forgotten: with the tremendous cost advantage of being able to avoid the special ethanol tariff, these imports wiped out established markets of the domestic industry in Florida, North Carolina and elsewhere, caused destabilization and losses in other markets and, we believe, ultimately displaced domestic ethanol production and reduced demand for corn.

The current threat of dehydrated heavily subsidized European wine alcohol being imported duty-free from the Caribbean is simply another way for importers to avoid the special tariff and obtain the benefit of the federal excise tax exemption which Congress intended they not receive.

The federal commitment to domestic ethanol production began in the late 1970's. As a result of the 1973 Arab oil embargo, and the resulting dramatic increase in fuel prices, the federal government recognized the need for a domestic renewable source of fuel that would decrease our dependence on foreign oil, increase our energy security and enhance our balance of trade. Ethanol satisfied all of these prerequisites, and in addition offered new markets for surplus farm production, increased farm income, increased rural employment, and a reduction in government farm support programs.

As a result, the federal government established as a national policy the encouragement of a domestic fuel ethanol industry. The most important element of the government program was an exemption from the federal excise tax on motor fuel for gasoline ethanol blends containing at least 10% ethanol.

In order to insure that the federal excise tax exemption encouraged the development of a domestic ethanol industry, in 1980, Congress enacted a special ethanol tariff -- currently 60 cents per gallon -- on imported fuel ethanol. The purpose of the tariff was to insure that the federal excise tax exemption benefit only domestic producers by directly offsetting the federal excise tax exemption which was available to all gasoline ethanol blends, including those containing imported ethanol.

*/ Conference Report, II-131 (September 18, 1986.)

As Senator Dole stated in explaining the tariff:

> Congress enacted the tax incentives in order to develop a domestic alcohol fuel industry in the United States . . . . In my view, we never intended these tax incentives to subsidize the use of imported alcohol . . . . In my view, Federal tax policy should be neutral toward these imports by denying a federal tax subsidy for imported alcohol. That is precisely what this tariff in this legislation will accomplish.

President Carter also urged that the federal excise tax incentive be available only to domestic ethanol producers. in a October 30, 1980, letter to Secretary of the Treasury, William G. Miller, President Carter stated:

> Foreign produced alcohol should not benefit from the exemption granted to gasohol from the four cent a gallon gasoline tax. This exemption should be applied only to domestically produced alcohol fuel, to encourage the growth of our domestic industry.

It is clear from the legislative history and from recent policy statements of the federal government that the principal intended beneficiary of domestic ethanol production was and is domestic agriculture. In a speech in August 1984 in Decatur, Illinois, President Reagan stated:

> [the] pioneer work in ethanol . . . increases demand for farm products, creates new jobs, and leads to greater energy security for our country . . . .We know the Federal Government has an important role to play as a partner to the farm community. I think the gist of that role is to help farmers do what they can't always do on their own -- seek out new markets, counter unfair trading practices of our trading partners, promote research, provide a measure of protection from erratic weather and natural disasters, and create a proper environment for supply and demand forces to allocate resources efficiently.

President Bush has also publicly and repeatedly endorsed the federal commitment to domestic ethanol production as a means of providing relief to the agricultural community and of reducing the federal debt arising from expensive farm price support programs.

Thus, the federal commitment to domestic ethanol production is a clear commitment to domestic agriculture and represents a federal policy choice that is bipartisan and strongly supported.

In this context, it is extremely important for the subcommittee to understand that this is not a typical case in which the question is merely whether a foreign product should be allowed duty-free entry. The unique question here is whether imported ethanol should be allowed an effective subsidy of 60 cents per gallon from the federal government because no corresponding duty is collected to offset the otherwise available tax exemption. the question, in short, is not whether there should be a duty-free entry, but whether Congress intended to subsidize foreign fuel ethanol. The indisputable answer is "no."

Although the Caribbean Basin Economic Recovery Act itself advances important federal policies, the subcommittee should also recognize, in the case of ethanol, that there is at least an equally important federal policy that is at stake. Duty-free imports of fuel ethanol would allow importers to circumvent the

clear intent of the federal incentive program for domestic fuel ethanol. By avoiding payment of the duty, the importers will receive the benefit of the federal excise tax exemption -- in effect, a subsidy from the federal government -- which Congress intended they not receive. For every 100 million gallons of ethanol blends imported duty-free, importers will receive the benefit of a subsidy of $60 million and the federal revenue will be deprived of a like amount. This is $60 million that Congress intended be offset be collection of the special tariff in order to avoid subsidizing imported fuel ethanol. It is in this context that the subcommittee should consider the questions before it.

As Congress intended, the domestic fuel ethanol program has been of enormous benefit to the agricultural community, particularly corn farmers. The principal feedstock used for domestic ethanol production is corn. Each bushel of corn yields approximately 2.5 gallons of ethanol. Since the inception of the domestic ethanol program, ethanol producers have utilized more than 2 billion bushels of corn. In 1989, the domestic fuel ethanol industry will utilize more than 360 million bushels of corn.

This new market for corn has increased the market price of corn, has reduced crop surpluses, has created thousands of new jobs in rural America and has reduced government farm support payments. On my own farm, I normally raise 875 acres of corn with a normal yield of 175 bushels per acre. Using a conservative 10 cent per bushel price increase resulting from ethanol production, this translates to at least $15,000 per year for my family and partners.

The National Corn Growers Association has supported, and continues to support, development of a full fermentation industry in the Caribbean, utilizing local Caribbean feedstocks. We believe that the encouragement of a truly indigenous ethanol industry in the Caribbean both serves the federal policy underlying CBERA and is consistent with the federal policy underlying the commitment to domestic ethanol production. We recognize the plight of the agricultural communities in these neighbor nations, and we support their sharing in the benefit of the federal excise tax exemption for ethanol blended fuels. A full fermentation ethanol industry in the Caribbean offers many of the advantages to our Caribbean neighbors that the domestic ethanol program offers to the United States: increased prices for agricultural products and new jobs in both agriculture and ethanol production, as well as increased energy independence and an improved balance of trade.

By the same token, the National Corn Growers Association strongly opposes making the federal subsidy for domestic ethanol available to ethanol transshipped to the United States from Europe and elsewhere through dehydration facilities in the Caribbean. Under the current legislation, importers are able to import large quantities of such transshipped alcohol duty-free. This can be done by the five companies that are "grandfathered" and thereby entitled to import 20 million gallons this year, with no "home grown" product requirement. It can also be done by all other importers, for whom only a percentage of the <u>value</u> of the ethyl alcohol or mixture must be "home grown" in order to qualify for duty-free treatment.

The dehydrators themselves admit that the potential annual capacity of dehydration facilities in the Caribbean approaches 200 million gallons. These dehydrators also argue that there can be no fermentation industry in the Caribbean unless they are allowed to blend with relatively large quantities of transshipped ethanol. Since the "home grown" requirement is stated in terms of value (not volume), dehydrators are able to blend large quantities of the cheaper European wine alcohol with only a small amount of the more expensive "home grown" alcohol to achieve the required percentage.

Encouragement of such operations to any extent both disserves the federal policy underlying CBERA and seriously undermines the federal policy underlying the promotion of a domestic industry. Any exploitation of this loophole by the transshipment and dehydration of European wine is a perversion of both of these policies. These dehydration facilities are clearly "pass through" operations. They offer none of the benefits to the Caribbean offered by a truly indigenous industry. Dehydration facilities are inexpensive to construct, requiring only a few months and very little Caribbean labor or materials. They employ only a small number of people and generate a relatively low level of local economic activity. Most importantly, they utilize no local feedstock. The dehydration-only facilities, in short, benefit mainly the Europeans, who can "dispose" of their excess subsidized wine alcohol, and the small number of dehydrators themselves -- most of them American companies -- who stand to make many millions of dollars. They do not benefit the Caribbean agricultural community.

More importantly for the National Corn Growers Association, these dehydration facilities pose the threat of huge losses to domestic corn producers, the general agricultural community, and the American taxpayer. For every 100 million gallons of displaced domestic ethanol, the effect on domestic corn producers and the federal government includes the following:

1. The federal government pays a $60 million dollar subsidy to foreign importers because of the failure to collect the special duty.

2. 40 ~~billion~~ million bushels of corn that could be used to produce the alcohol is displaced and added to the supply of the corn on hand.

3. Assuming an average yield of 120 bushels of corn per acre, 330,000 acres worth of corn production is unused.

4. Assuming an average of 250 acres of corn per farmer, the crop of 1300 corn farmers is not needed.

5. The overall price of corn is reduced, hurting all corn farmers.

6. The U.S. Department of Agriculture pays millions of additional dollars in price support payments, plus future storage charges and internal costs, to acquire the corn and out it into storage.

7. The benefit of payrolls in rural communities are diminished even further in an already depressed U.S. farm economy.

Even if these imports did not directly displace domestic ethanol production, these imports -- even the threat of these imports -- retards expansion of the domestic ethanol industry and subvert the Corn Growers objective of creating an annual demand for ethanol of 1.2 billion bushels of corn.

The National Corn Growers Association submits that this is an outrageous and totally unacceptable price to pay to help the European wine alcohol "disposal" problem and to line the pockets of a few dehydrators. Put another way, if the necessary cost to federal policy objectives and domestic agriculture of a small indigenous ethanol industry in the Caribbean is the potential importation duty-free of large amounts of transshipped ethanol from Europe and elsewhere, then the cost is too high and it should not be sanctioned by the Congress.

The National Corn Growers Association therefore requests that this abuse of both federal commitment to domestic ethanol production and the CBI legislation be eliminated, or, at a minimum, that the current "home grown" product requirement be maintained or strengthened in the new CBI bill this subcommittee will consider.

Chairman GIBBONS. Mr. Snyder, I know you are here on behalf of the Corn Coalition. Herb Waters is ill, and I hope he recovers soon.

STATEMENT OF WILLIAM E. SNYDER, COUNSEL, ON BEHALF OF THE CORN COALITION

Mr. SNYDER. Thank you very much, Mr. Chairman, Congressman Matsui.

My name is William Snyder. I am with the law firm of Chadwell & Kayser in Chicago. As you said, I am appearing this afternoon on behalf of the Corn Coalition. The Corn Coalition is an alliance between the Interunion Corn Wet Milling Council of the AFL–CIO, which consists of six international unions having contracts in 16 corn wet milling plants, and corn-refining companies that operate such plants. We appreciate the opportunity to present the views of the Corn Coalition concerning this troubling aspect of the Caribbean Basin Initiative.

I have submitted to the committee a prepared written statement, along with two exhibits, that I would like to have included in the record.

Chairman GIBBONS. Without objection, they will be included.

Mr. SNYDER. Thank you, sir. Rather than read my entire prepared written statement, particularly in view of the hour, I would like to just summarize one or two of the most important aspects of it and comment, if I may, on one or two issues that have come up during the course of the extended dialogue this afternoon.

First of all, while a great deal of attention has been paid to the objectives of the Caribbean Basin Initiative, and justifiably so, I believe that this controversy can only be understood in full context if attention is also paid to another legislative scheme, and that is the Energy Tax Act.

The Energy Tax Act was passed for the purposes of encouraging an ethanol industry in the United States for essentially four reasons, four objectives that the Congress identified that a domestic ethanol industry would serve. It would enhance the utilization of American agricultural products, principally corn; it would enhance job creation in the agricultural processing and related industries; it would reduce the Nation's dependence on foreign energy supplies; and it would improve the Nation's balance of trade.

The legislative scheme was fairly simple. It was an excise tax for blended fuel that consisted of 10 percent ethanol, 90 percent gasoline. When the tax was originally imposed, it was 4 cents, so the tax break or tax incentive was 4 cents per gallon. Since ethanol represents only one-tenth of the gallon, the equivalent value that that added to the ethanol was 40 cents. When the tax was later raised, the incentive became 6 cents per gallon, giving ethanol an equivalent value or tax incentive of 60 cents.

Congress determined that its objectives would not be served if the tax incentive applied to imported ethanol. Imported ethanol would not increase use of corn in the United States. It would not create jobs in the United States. It would hurt rather than help our balance of payments, and, needless to say, it would enhance rather than improve our dependence on foreign energy supplies.

Chairman GIBBONS. Can you tell me when we decided all that?

Mr. SNYDER. I beg your pardon, sir?

Chairman GIBBONS. Can you tell me when we decided all that?

Mr. SNYDER. When the Energy Tax Act was passed? I believe 1975, but let me give you the exact year.

Chairman GIBBONS. That was superseded by the Caribbean bill.

Mr. SNYDER. Excuse me; 1979.

Chairman GIBBONS. It was superseded, then, by the Caribbean bill.

Mr. SNYDER. I believe the CBI supplements, but I think "supersede" is the wrong word.

Chairman GIBBONS. You all did not raise any objection to it.

Mr. SNYDER. When the CBI was considered, as best I can tell from the history of the entire matter, the subject of producing ethanol from nonindigenous feedstocks did not even exist when the CBI was considered. My understanding is that that was not being done at the time. It may not even have been thought of by anybody.

As I recall Mr. Vin's testimony, he was more or less the inventor of that concept, and I do not believe he even thought of it until after the CBI had been passed. So you are right, the subject simply did not come up.

Because the Congress determined that the benefits of the Energy Tax Act would not be realized if the tax incentive applied to imported ethanol, it adopted a tariff that was designed specifically and precisely to offset——

Chairman GIBBONS. I was there when that travesty was committed. You do not need to tell me about that one. Bob Dole was there in the middle of the night, and apparently they caved in. And before I could do anything about it, it had already been agreed to. But you do not need to tell me what Congress did because I was there that night.

Mr. SNYDER. Well, Mr. Chairman——

Chairman GIBBONS. It was over before anything could be done about it.

Mr. SNYDER. It does not sound to me that I am going to be able to disabuse you of that point of view.

Chairman GIBBONS. I can tell you right where it was. I know where I was sitting. I was sitting on the couch in the lobby of the Ways and Means Committee room when Vanik caved in to Dole.

Mr. SNYDER. Well, there is no question——

Chairman GIBBONS. It was over. He announced he had done it, and it was too late to do anything about it.

Mr. SNYDER. There is no question about the fact that the tariff was adopted, nor could there seriously be question that——

Chairman GIBBONS. But I do doubt all that legislative history because nothing took place in my presence, and I was there the whole time. If there is any legislative history, it is all in Senator Dole's head or his staff's heads.

Mr. SNYDER. Well, I do not see how there could be any question but that the four objectives of establishing the use of——

Chairman GIBBONS. You are wrong, you are just dead wrong. I was there. There was never any discussion about the thing. Dole wanted as a condition to agree to the Tax Act a 50-cent-a-gallon

tariff. It was all aimed at Brazilian alcohol, and that is all it was aimed at.

Mr. SNYDER. I do not think there is a distinction between which foreign country it comes from. The point is that the four benefits——

Chairman GIBBONS. I was there. I know we were talking about Brazilian alcohol, and that was all that was discussed at that time.

Mr. SNYDER. I am not disputing that. But the point is, whether it is Brazilian or European, importing that ethanol does not serve any of the purposes of the Energy Tax Act. That is my only point. And that is why the tariff was adopted.

Chairman GIBBONS. The tariff was adopted because Dole would not give in, and we had to do something. And Vanik did it without the consent of this committee or any of the conferees. He came in and announced it was over. I was there, sir. It happened between 2 and 4 o'clock in the morning.

Mr. SNYDER. Nothing I am saying is inconsistent with that. I am not disputing your——

Chairman GIBBONS. Don't tell me what Congress meant to do. Congress did not mean to do a darn thing. We just had to get the conference agreement.

Mr. SNYDER. All right. We know what Congress did, in any event.

Chairman GIBBONS. They had some staff get together and write some restrictions to go along with it.

Mr. SNYDER. Well, in any event, the significance of the tariff is that it distinguishes ethanol from all of the other products to which the tariffs and the CBI apply. There is an ad valorem tariff that applies to a broad range of products. The chairman mentioned some of those, such as flowers and juice and many other products. But the 60-cent tariff on ethanol is unique. It does not apply——

Chairman GIBBONS. That came about 5 years before the CBI bill.

Mr. SNYDER. That is right. That is right.

Now, with that in mind, many of the considerations that have been advanced with respect to, well, why is this the only industry that is addressing the issue? Why should the 35 percent value-added requirement apply to these many other products but not apply to ethanol? The answer simply is that ethanol is the one product that receives a Federal tax incentive. And so that when you give duty-free treatment to imported product, it gets a Federal tax incentive, too.

That is not the case with respect to juice or flowers or the many other products that are imported under the CBI. So this is not purely a trade or tariff issue. The issue is: Should imported ethanol receive a Federal tax subsidy?

Now, we have no quarrel——

Mr. MATSUI. Are you suggesting that because the industry you are representing receives a subsidy, we should treat ethanol differently in the Caribbean countries? Is that what you are suggesting?

Mr. SNYDER. I am suggesting that the issue is whether ethanol that is imported should receive the benefit of the tax incentive which Congress applied specifically to the domestic industry. I am not challenging it with respect to fully fermented fuel ethanol from the Caribbean, because Congress has determined that granting favorable trade status for that product——

Mr. MATSUI. I really do not understand. What are you trying to get to? Tell me what you are trying to do.

Mr. SNYDER. I am trying to distinguish the duty-free status that is accorded to ethanol from the many other products that are imported under the CBI.

Mr. MATSUI. Are you suggesting that the reason that you distinguish it is because you get a subsidy from the Federal Government?

Mr. SNYDER. Because there is a subsidy on ethanol, yes.

Mr. MATSUI. Boy, that is a really weird argument. I have never heard an argument quite that illogical.

Mr. SNYDER. Well, let us start first of all with whether it is true. Let us start——

Mr. MATSUI. I am amazed that you would even suggest something like that before a committee of Congress. Because you receive a subsidy, as a result of that, we should treat that product differently coming into the United States. It makes no sense at all.

Mr. SNYDER. Well, let us see if I can explain it. All of the other products that receive duty-free treatment receive an exemption from an ad valorem tariff. Of course, that applies to ethanol, too. But when ethanol comes in, it receives the benefit of a tax incentive. It is going to get the tax incentive anyway. The question is: Will there be a tariff to offset that?

Mr. MATSUI. Mr. Snyder, are you saying that if we take the tax incentive away that then you would not have any problems with ethanol coming in?

Mr. SNYDER. That is exactly what the tariff does.

Perhaps I have not explained myself, or perhaps it has not been fully thought through. But when the tariff was adopted, the only reason it was adopted, as I understand it, was there is no practical way to limit the tax incentive to domestic product. It applies at the pump. The products are fungible. There is no practical way for the tax incentive to have said: This only applies to domestic ethanol. In terms of practicality, it has to apply to all ethanol. But since it was decided not to extend the benefit to imported ethanol, a precisely offsetting tariff was adopted, 40 cents originally, now 60 cents. So this product is——

Chairman GIBBONS. That discussion never took place. I was there. You do not need to try to re-create history for me. I was there that night. Charlie wanted something, and the Senator wanted something. And they both got what they wanted, and we got shafted.

Mr. SNYDER. Well, I am not trying to read anybody's mind. I am simply pointing out what—the tariff is, in fact, in place, and its effect is to offset the subsidy so that to give duty-free status is, in effect, to give the tax incentive subsidy to the imported product.

Now, we have no objection to doing that if giving the tax subsidy benefit to the imported product provides a demonstrable benefit to the CBI. We have no challenge to that. We think it serves the national interest to provide economic development and employment in the CBI. But we think there should be a heavy burden of proof to justify giving that tax incentive, the subsidy, to a product whose benefit to the CBI is extremely dubious.

Chairman GIBBONS. You all had plenty of chance to come up and volunteer to testify before us in the CBI hearings. They were held for 2 years in both the House and the Senate. I never heard from you.

Mr. SNYDER. No, as I said before, I do not think anybody thought about the European wine alcohol.

Chairman GIBBONS. The story you are weaving there is the greatest piece of fiction I have heard in a long time.

Mr. SNYDER. Well, again, to the extent there is mind-reading involved, I do not intend to suggest that. All I am saying is that we have a tax incentive for ethanol, and the effect of the 60-cent tariff is to offset it. And given the fact that the tax incentive originally was 4 cents a gallon, the equivalent of 40 cents for ethanol, and then the tariff was 40 cents, when the tax incentive went up to 66 cents per gallon for blended product, the tariff was raised to 60 cents. It seems to me the inference is obvious. The tariff has tracked the tax incentive, and its effect is beyond dispute. Its effect is to precisely offset the benefit of the tax incentive.

Chairman GIBBONS. You can erect a monument in the corn fields out there to Bob Dole; he did it.

Mr. SNYDER. The point that I'm driving at is the burden to justify extending the tax incentive to import a product. It should be a relatively heavy one. And the imported product that is made from European wine alcohol has no benefit that serves the national interest. It doesn't have any of the benefits to the United States directly of job creation, use of agricultural products. It doesn't have the benefit of reducing our dependence on foreign energy supplies. It doesn't help our balance of payments.

The problem is it doesn't materially benefit the CBI either. That's the problem.

Chairman GIBBONS. It helps to bring the price of your product down to be competitive. That's a benefit.

Mr. SNYDER. Well, only in a sense, because the risk is displacement of domestic ethanol. And displacement of domestic ethanol is exactly contrary to what we understand the purposes of the tax incentive to be. As I said, increased use of American grain, increased employment, reduced dependence on foreign energy supplies.

For every gallon of ethanol that is displaced, you lose those advantages.

Chairman GIBBONS. We are talking about Arabs. We're not talking about Europeans, not talking about dependence on foreign oil.

Are there sources for your statement? I have heard a lot of fairy tales in my 27 years here, but this is the best that I've ever heard, Mr. Snyder. Go ahead.

Mr. SNYDER. I think I've about exhausted what I have to say to that, except it's news to me. It's news to me that our national energy policy of reducing foreign dependence is limited, just Arabian petroleum.

At the time it was considered, that was the biggest source concededly. But it's news to me if it's limited, just the sources of American petroleum.

Now, I'm taking more time than I probably should. There is another point I would like to make, however, and it is on a completely different subject.

Many of the things that the witnesses for the other side today have said, I don't understand the logic of.

The grandfather provisions that are in effect now and are to expire at the end of this year are 20 million gallons per plant, and I believe there are five plants. Now, we have a new player in the game, VIAG, which would be a sixth plant. So if the grandfather provisions were simply extended for those six plants, they would be a 120 million gallons.

Chairman GIBBONS. You said that the Virgin Islands have no representation in Congress. VIAG is in the Virgins?

Mr. SNYDER. I believe that is in the Virgin Islands, yes. Yes. But it's the sixth plant.

So what I understand them to be asking for is 120 million gallons. Yet, to justify that, we keep hearing arguments how they can't get in that indigenous supplies where what they can get isn't really satisfactory. It's a low quality product or and so on and so on.

And I don't understand how they can justify asking the Congress to authorize 120 million gallons if the premise is that their sales will be much smaller. It will only be 3 percent market penetration, which is much less than that. They won't get the supplies, and so on and so on and so on.

The whole premise of their argument is that they can get the supplies or they wouldn't have an argument at all.

So I think talk about whether or not the Europeans have sold wine alcohol in recent months, and whether market penetration in the last 2 or 3 years has been more than 3 percent is really beside the point. The question is, is it or is it not in the national interest to authorize the importation of up to 120 million gallons of ethanol that is made by the dehydration of product that is not indigenous to the CBI. That's the question. That is what they want us to give them, and that's what we ought to consider.

Not whether they will actually use it or not, because if they are not going to use it, there's no rationale for giving it to them in the first place. So that is the comment I wanted to make on that score.

I have a long list, but I'm concerned that I may be taking more time than I'm entitled to. So I think I will conclude on that point.

Thank you so much, Mr. Chairman.

Chairman GIBBONS. Your statement will be included in the record.

Mr. SNYDER. Oh, yes. I would like to have my statement and the exhibits to it included in the record.

Chairman GIBBONS. They will be included.

Mr. SNYDER. Thank you, sir.

[The statement of Mr. Snyder follows:]

BEFORE THE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TRADE

Statement of William E. Snyder, On Behalf
Of The Corn Coalition, Re H.R. 1233,
Caribbean Basin Initiative, April 25, 1989

My name is William E. Snyder, with the law firm of Chadwell & Kayser, Ltd. in Chicago. I am appearing this afternoon on behalf of The Corn Coalition. The Corn Coalition is an alliance between: (1) the Interunion Corn Wet Milling Council, AFL-CIO, which consists of six international unions having contracts in sixteen corn processing plants; and (2) the corn refining companies that operate such plants. The Corn Coalition appreciates the opportunity to present its views to the Committee concerning an important and troubling aspect of the Caribbean Basin Initiative, specifically, the duty-free importation of fuel ethanol consisting largely of cheap, heavily subsidized European wine alcohol that is merely dehydrated in CBI countries.

The ethanol controversy concerns two federal legislative programs that were adopted by Congress to achieve different but entirely consistent objectives, and a statutory loophole that has been used to make the two programs work at cross purposes for the benefit of a few trading companies. Although Congress recognized and closed the loophole in 1986, the same interests that richly benefited from it are now working to have it re-opened and made permanent.

The first such program was the Energy Tax Act, which Congress passed in 1978 to encourage and facilitate the development of a domestic industry for the production of ethanol as an alternative fuel additive. Congress exempted gasoline-ethanol blends containing ten percent ethanol ("gasohol"), from the gasoline excise tax, recognizing that the use of ethanol would: (1) strengthen our agricultural economy by significantly enhancing utilization of corn, from which ethanol is made; (2) reduce our dependence on foreign energy supplies; (3) improve the nation's balance of trade; and (4) enhance job creation directly in the agricultural products processing and related industries and indirectly in other sectors of the economy.

Obviously, these advantages inure only from use of domestically produced ethanol from domestic feedstocks. Thus, Congress determined that the tax incentive would only apply to domestically produced ethanol. Since there was no practicable way to distinguish between gasohol containing domestically produced ethanol and that containing imported ethanol at the point of retail sale, Congress imposed a tariff on imported ethanol in an amount that precisely offset the tax incentive applicable to ten percent ethanol blends. Initially, when the tax incentive was 4-cents per gallon, the ethanol tariff was 40-cents. When the tax incentive became 6-cents per gallon, the tariff was raised to 60-cents per gallon.

Thus, the purpose of the excise tax exemption was and remains the promotion of a domestic fuel ethanol industry. A precisely offsetting tariff was imposed because the Congress did not intend to subsidize foreign ethanol production, which has none of the benefits that I just mentioned. In short, this

tariff is unlike most other tariffs in that it is a tariff that precisely offsets the benefits of a federal tax incentive, because the very purposes of the incentive are inherently limited to domestically produced ethanol.

The second legislative program to which I referred is the Caribbean Basin Initiative ("CBI") which took effect on January 1, 1984. The CBI permits duty-free importation of products and materials from specified countries in the Caribbean Basin area, on the premise that expanding CBI countries' export markets will enhance economic and social development, and thus political stability, within the region.

The statutory loophole that has been used to set these two programs at cross purposes is quite simple. Although there are full fermentation plants in several CBI countries that are capable of producing alcohol from locally-grown feedstocks (principally sugar cane), most of the ethanol that has been exported to the United States under the CBI has not been derived from feedstocks indigenous to the region. Instead, the great preponderance of ethanol exported duty-free under the CBI has been derived from wine alcohol that is heavily subsidized by European governments and sold below cost on the world market. A few companies have built facilities in the CBI region that do nothing more than remove water from the European wine alcohol, and then export the resulting fuel grade ethanol to the United States. Such alcohol, which would be subject to 3% ad valorem and 60-cents per gallon duties if imported to this country directly from Europe, just passes through the CBI countries to have water removed, and is then brought to the United States duty free to compete with domestically produced ethanol, enjoying the benefits of the incentives provided by the Energy Tax Act. The report on ethanol imports under the CBI that was issued last February by the International Trade Commission disclosed that more than two-thirds of such ethanol consisted of cheap, heavily subsidized European wine alcohol that was merely dehydrated in CBI countries before being shipped to this country.

As a result of this loophole, the dehydrators of cheap European wine alcohol have reaped substantial profits, being able to recoup the cost of constructing their dehydration facilities in a matter of months. They have been able to take full advantage of the federal tax incentives that were intended to apply only to ethanol produced in the United States from agricultural products grown in the United States. Their ethanol has displaced domestically produced ethanol in many saturated markets, reducing utilization of American grain, and reducing employment in American corn refining plants.

On the other hand, dehydration of European wine alcohol provides very little economic development and employment in CBI countries, which the CBI was designed to produce. It provides minimal local employment and none in the agricultural sector. Being located in free trade zones and receiving tax exemptions from host countries, dehydration plants generate little if any foreign exchange or government revenue. What is worse, dehydration operations in the Caribbean Basin have actually retarded the development of full fermentation ethanol production facilities in the region, which would use indigenous feedstocks such as sugar cane and provide substantial capital investment and employment.

Congress recognized this loophole, and included provisions in the Tax Reform Act of 1986 to close it. Specifically, Congress required that ethanol imported from the CBI contain minimum percentages of CBI-indigenous feedstocks by value: 30% in

1987, 60% in 1988, and 75% in 1989 and thereafter. These indigenous-content requirements were established to induce the dehydration-only companies and others to invest in full fermentation plants capable of making ethanol from domestic CBI feedstocks. Several of the existing dehydrators, however, persuaded Congress to "grandfather" them through 1988, and their exemption from the above requirements was extended through 1989 by the Omnibus Trade Act of 1988.

Now, the dehydrators are seeking to have the indigenous feedstock requirements abolished altogether, or to have the grandfather exemptions extended beyond 1989. Any such proposals to re-open the ethanol loophole should be rejected. While the Tax Reform Act was under consideration in 1986, certain companies that were dehydrating European wine alcohol in CBI countries for duty-free export to the United States claimed that they required limited time to continue processing European wine alcohol in order to recoup their investments and/or expand their operations to include facilities for production of alcohol from CBI-sourced feedstocks. The grandfather exemptions from indigenous feedstock requirements were granted by Congress in reliance on those representations. Now, some three years later, the dehydrators have had ample time to recoup their investments in dehydration facilities many times over, and to expand their dehydration facilities to full fermentation plants, which would use feedstocks derived from CBI sugar cane exclusively, if it was their true intention to do so.

The Corn Coalition supports the objectives of the Caribbean Basin Initiative, but those objectives would not be served by eliminating or reducing indigenous feedstock requirements for fuel ethanol, or extending grandfather exemptions beyond 1989. Such action would benefit the dehydrators themselves, who will use as much cheap European wine alcohol, and as little feedstock from CBI-indigenous products, as the law permits. And, of course, such action would help European countries dispose of their enormous wine alcohol surpluses, which are the result of governmental subsidies. But reducing or eliminating indigenous feedstock requirements would not appreciably enhance development in the CBI region. Instead, it would increase imports of foreign-produced ethanol that would largely displace American-produced ethanol. When we remember that the purposes of the federal tax incentive for ethanol-gasoline blends were: increased utilization of American grain, job creation in the domestic grain refining industry, reduced dependence on foreign energy supplies, and improvement of the balance of trade, it is obvious that such action would be counter-productive.

The Corn Coalition has submitted to the Committee along with this statement a report to the Congress, entitled "The Congress Should Not Eliminate Indigenous Alcohol Feedstock Requirements For Duty-Free Importation Of Ethanol Under The CBI, Or Extend Grandfather Exemptions Beyond 1989", which sets forth in greater detail the facts and considerations underlying its position. I request that the report be included in the record. Again, on behalf of the Corn Coalition I want to thank the Committee for the opportunity to appear and to present the Corn Coalition's views on this important subject.

William E. Snyder
CHADWELL & KAYSER, LTD.
35 W. Wacker Dr., Suite 3300
Chicago, IL 60601-1698
(312) 419-7500

On Behalf Of The Corn Coalition

SUMMARY OF REPRESENTATIONS MADE BY CBI ALCOHOL DEHYDRATORS IN ORDER TO OBTAIN "GRANDFATHER" EXEMPTIONS FROM INDIGENOUS FEEDSTOCK REQUIREMENTS, CONCERNING TIME NEEDED TO CONVERT TO SUBSTANTIALLY COMPLETE USE OF CBI-INDIGENOUS FEEDSTOCK

SUBMITTED TO

THE UNITED STATES CONGRESS
HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TRADE

BY

THE CORN COALITION

CHADWELL & KAYSER, LTD.
35 W. Wacker Drive
Suite 3300
Chicago, IL 60601
(312) 419-7500

While the Tax Reform Act was under consideration in 1986, three companies (Tropicana Petroleum, Ltd., Chemical Fuels Corp. and Allied Ethanol & Fuel Corp.) claimed that they had invested in the construction of dehydration facilities in reliance on the law as it existed in 1985 -- specifically, in reliance upon rulings of the U.S. Customs Service that anhydrous ethanol made by dehydrating hydrous wine alcohol was eligible for duty free importation under the CBI. Thus, these dehydrators claimed that they required limited time to continue processing European wine alcohol in order to recoup their investments and/or expand their operations to include facilities for production of alcohol from CBI-sourced feedstocks.[1/] Therefore, Congress included "grandfather" provisions in the Tax Reform Act, exempting from the indigenous feedstock requirements 20 million gallons of ethanol per year for three facilities through 1988. The Omnibus Trade Act of 1988 extended the grandfather provisions through 1989, and applied them to two additional plants (Petrojam of Jamaica, and the LAICA plant at Punta Morales, Costa Rica).

Now, some three years later, the dehydrators contend that minimum indigenous feedstock requirements should be eliminated entirely or significantly reduced, and/or that their "grandfather" exemptions should be extended even further. It would be well to recall at this time the representations that the dehydrators made to Congress back in 1986, concerning their professed intentions to use primarily CBI-indigenous feedstocks in the near future. Congress provided "grandfather" relief in reliance on the dehydrators' assurances that they needed limited time to "backward integrate", i.e., to expand their dehydration facilities to plants that would use feedstocks derived from CBI sugar cane exclusively. Those assurances were dubious to begin with and have not come to fruition.

Tropicana

Tropicana testified before the House Subcommittee on Trade in February, 1986, that it invested in the Kingston, Jamaica dehydration facility in reliance on the CBI as it then existed.[2/] The testimony did not focus on just how much that investment was, nor did it disclose that Tropicana was able to recoup its investment in the first year of operation. Rather, one month later, Tropicana wrote to the Committee, proclaiming Tropicana's objective of using 100% CBI-sourced feedstock by 1990, specifically claiming that Tropicana would: (1) build a fermentation and distillation plant in Belize, to use locally produced molasses and surplus sugar, hopefully to commence by the 1987-1988 cane season; and (2) obtain a rum distillery in St. Lucia to produce alcohol from CBI molasses, beginning with the 1986-1987 season.[3/]

Under the Tax Reform Act of 1986 and the Omnibus Trade Act of 1988, Congress exempted Tropicana from minimum CBI feedstock requirements through 1989, giving the company even more time to make money and backward integrate than it had requested. Tropicana had no reason to expect any more time and has done nothing in reliance on such an expectation.

Two and one-half years after its Congressional testimony, Tropicana was represented at a hearing before the International

---

1/ Allied Ethanol & Fuel Corp., Ltd., Chemical Fuels Corp., Tropicana Petroleum, Ltd., Statements To Subcomm. On Trade, House Comm. On Ways & Means, Feb. 6, 1986, pp. 490, 446-49, and 417, respectively.

2/ Tropicana Petroleum Ltd., Ibid., pp. 411, 415.

3/ Tropicana Int'l (Jam.) Ltd., Statement Before Subcomm. On Oversight, House Comm. On Ways & Means, Feb. 27, 1986, pp. 828-31.

Trade Commission. Tropicana did not report on its progress in replacing European wine alcohol with CBI-sourced feedstocks or in making the acquisitions that it had forecasted in early 1986. Instead, Tropicana insisted that imposition of any indigenous feedstock requirement by volume would render the company's investment "entirely . . . valueless".4/

Recently, Tropicana has disseminated a proposal for amendment of the Tax Reform Acts's indigenous feedstock requirements. Tropicana states therein that its expansion into cane production was delayed because "in late 1985 . . . the [Jamaican] Government reneged on its promise to lease Bernard Lodge [Sugar Estate] to Tropicana." Tropicana's proposal does not explain, however, its subsequent representations to the Congress in 1986.

BioCom/CFC

Chemical Fuels Corp. of Atlanta, Georgia ("CFC") is a wholly owned subsidiary of BioCom International, Ltd., an Australian company, having been acquired in June, 1987. In February, 1986, CFC submitted a statement to the House Oversight Subcommittee in which it said that it was developing a full fermentation facility on St. Croix, U.S. Virgin Islands, that would produce ethanol from sugar cane juice, high-test molasses and possibly raw sugar, which was planned for completion at the end of 1986.5/ Two weeks earlier, CFC advised the House Trade Subcommittee that: (1) CFC's distillation facility would be operable around April 1, 1986; (2) CFC would have to dehydrate imported (i.e., non-CBI) alcohol while the fermentation plant was under construction; and (3) the "entire A to Z fermentation facility" would be completed by the end of 1986.6/

In reliance on CFC's representations that its dehydration facility would come onstream around April, 1986, and its full fermentation facility would be completed by the end of 1986, Congress exempted CFC from the Tax Reform Act's CBI-feedstock requirements for one year, through 1987, and the Omnibus Trade Act extended the exemption for 20 million gallons through 1989.

Apparently it was the Congress that was mislead into relying on CFC's representations, rather than vice versa. As of February, 1988, not even CFC's dehydration facility, let alone its alleged fermentation plant, had commenced operation. CFC claimed that its dehydration plant would come on-line by April 1, 1988, and that full fermentation would begin by mid-year.7/ By August, however, the facilities were still unborn, CFC claiming that its plant was "95% complete" and that construction would "resume" as soon as the Omnibus Trade bill was signed.8/ By August 29, the dehydration portion reportedly was "97% complete", and it was "not certain" when the fermentation portion would be finished.9/ In October, 1988, BioCom advised the International Trade Commission that CFC's dehydration facility was 95% complete, without explaining what had

---

4/ Tropicana Energy Co., Inc., Testimony Before U.S. Internat'l Trade Comm'n, Oct. 27, 1988, pp. 98-99.

5/ Chemical Fuels Corp., Statement To Subcomm. On Oversight, House Comm. On Ways & Means, Feb. 27, 1986, p. 855.

6/ Chemical Fuels Corp., supra n.1, p. 449.

7/ Alcohol Week, Feb. 22, 1988, p. 3.

8/ Alcohol Week, Aug. 8, 1988, p. 4.

9/ Alcohol Week, Aug. 29, 1988, p. 8.

become of its full fermentation facility.[10] To date, CFC has not opened its plant and produced any ethanol whatsoever.

Allied Ethanol & Fuel Corp., Ltd.

Allied Ethanol & Fuel Corp., Ltd. ("Allied") is a joint venture comprised of Minneapolis, Minn., Baton Rouge, La., and Kingston, Jamaica interests. In a statement to the House Trade Subcommittee in February, 1986, Allied said that it was constructing an alcohol dehydration facility in an unidentified CBI country, in reliance on the CBI and the Customs Service's ruling.[11] Like Tropicana, Allied was grandfathered under the 1986 Tax Reform Act through 1988, and was granted a further extension through 1989 by the Omnibus Trade Act of 1988. Thus, Allied was given ample time to recoup its investment in dehydration (it did not ask for more), and to expand into full fermentation if it so chose.

In May, 1988, Allied announced that it would begin production at a 42 million gallon capacity Grand Bahama facility in June, and that while 20 million gallons were exempt from the CBI-content requirements of the Tax Reform Act, it would ferment its own alcohol locally to meet the 60% requirement for the remainder of its production.[12] In August, 1988, Allied said that construction of its facility had been "on hold" pending passage of the Omnibus Trade Act, and that it was then "a few weeks away" from completion.[13] To date, Allied still has not commenced production of ethanol.

Petrojam

Petrojam is a wholly-owned subsidiary of the Petroleum Corporation of Jamaica, the state energy company of the Government of Jamaica. No representative of Petrojam or the Jamaican Government appeared before either the House Trade or Oversight subcommittees while the indigenous feedstock provisions of the Tax Reform Act were under consideration in 1986. However, counsel for both entities wrote letters to the Trade Subcommittee, advising that Petrojam was investing $4 million for infrastructure and plant construction of a dehydration facility, for the purpose of making fuel ethanol for export to the United States under the CBI.[14] The clear thrust of Petrojam's position was not that it intended to dehydrate non-CBI alcohol on a long-term basis, but that it would use Jamaican and other CBI-sourced feedstocks. Counsel for the Jamaican Government said that:

> The Government of Jamaica and the state petroleum company, Petrojam, is also committed to the development of a fully integrated ethanol project that will eventually utilize 100% Jamaican feedstocks.[15]

Both letters stated that Petrojam was rehabilitating the Bernard Lodge sugar estate for the purpose of supplying feedstock to the

---

10/ BioCom Int'l, Ltd., Statement to U.S. Int'l Trade Comm'n, Oct. 27, 1988, p. 2.

11/ Allied Ethanol & Fuel Corp., supra n.1, p. 490.

12/ Alcohol Week, May 9, 1988, p. 3.

13/ Alcohol Week, Aug. 8, 1988, p. 4.

14/ T.B. Evans and H.J. Fenton, Letters dated Feb. 11, 1986, reprinted in Hearings Before Subcomm. on Trade, House Comm. On Ways and Means, Feb. 6, 1986, pp. 606, 636.

15/ Ibid., p. 606.

dehydration plant. The Trade Subcommittee was told that dehydration of non-CBI alcohol was just an "interim step," that by mid-1986, 9 million of the 40 million gallons of ethanol production would be supplied from Jamaican sources, and that in five years all of the feedstocks would come from Bernard Lodge.[16] Further, in 1987 Petrojam lease-purchased cane fields in Belize, and has expressed an intention to buy more of same in 1989.[17] Petrojam has announced plans to build a fermentation facility in Belize, to produce hydrous (wet) alcohol which would be shipped to its dehydration facility in Kingston, Jamaica.[18]

Since Petrojam claimed to be on a fixed course for the manufacture of ethanol from Jamaican and other CBI-sourced feedstocks, it did not seek and was not granted an exemption from the CBI-content requirements of the 1986 Tax Reform Act. It was, however, granted an exemption for 20 million gallons through 1989 by the Omnibus Trade Act. Petrojam's investment in ethanol facilities was not made in reliance upon an expectation that ethanol made from non-CBI feedstocks would remain eligible for CBI treatment, but was based on its plans to develop its own sugar fields to supply feedstocks for ethanol production.

SUMMARY

In the CBI proposal recently disseminated by Tropicana, which is referred to above, Tropicana states that it was the:

> "... only ethanol producer who invested in an azeotropic dehydration facility in good faith prior to any congressional action being undertaken [to require minimum indigenous feedstock requirements]. All other investors who followed Tropicana's lead were advised by United States Government officials that it would be unwise to invest in dehydration facilities as legislation was then pending which would amend the CBERA to eliminate the financial viability of these facilities. (Emphasis added.)

Clearly, none of the dehydrators has been unfairly disadvantaged by amendments to the CBI. Tropicana has recouped its investment in dehydration facilities many times over. It and other dehydrators obtained "grandfather" exemptions, which will expire at the end of 1989, on the unqualified representations that they required even less time than they were ultimately given to convert to use of substantially CBI-indigenous feedstocks. Their renewed efforts to avoid compliance with minimum indigenous feedstock requirements confirm what should have been obvious all along -- that they want to dehydrate as much cheap, heavily subsidized European wine alcohol as they can, and for as long as they can, and to use as little CBI-indigenous feedstock as they can persuade the Congress to allow.

Respectfully Submitted To
The United States Congress

By

The Corn Coalition

CHADWELL & KAYSER, LTD.
35 W. Wacker Dr., Suite 3300
Chicago, IL 60601-1698
(312) 419-7500

16/ Ibid., pp. 606-07.

17/ Petrojam, Ltd., Pre-hearing Brief Submitted to U.S. Internat'l Trade Comm'n, Oct. 20, 1988, p. 8.

18/ Alcohol Week, Feb. 22, 1988, pp. 1, 4.

THE CONGRESS SHOULD NOT ELIMINATE INDIGENOUS ALCOHOL FEEDSTOCK REQUIREMENTS FOR DUTY-FREE IMPORTATION OF ETHANOL UNDER THE CBI, OR EXTEND GRANDFATHER EXEMPTIONS BEYOND 1989.

A REPORT TO

THE UNITED STATES CONGRESS

WITH ADDENDUM RE

FEBRUARY, 1989 REPORTS OF

THE INTERNATIONAL TRADE COMMISSION

and

THE GENERAL ACCOUNTING OFFICE

Submitted By

THE CORN COALITION

CHADWELL & KAYSER, LTD.
35 W. Wacker Dr., Suite 3300
Chicago, IL 60601-1698
(312) 419-7500

THE CONGRESS SHOULD NOT ELIMINATE INDIGENOUS ALCOHOL FEEDSTOCK REQUIREMENTS FOR DUTY-FREE IMPORTATION OF ETHANOL UNDER THE CBI, OR EXTEND GRANDFATHER EXEMPTIONS BEYOND 1989.

SUMMARY (1)

I. Federal Tax Incentives Were Adopted Solely To Promote A Domestic Ethanol Industry Using Domestic Feedstock Sources. (4)

1. National interests (4)

(a) Increased demand for corn
(b) Improved trade balance
(c) Energy security
(d) Environment
(e) Employment

2. U.S. & state tax incentives (5)

3. Growth of U.S. ethanol industry and corn utilization; reduced imports (5)

4. Applies only to domestically produced ethanol; hence duties imposed on imported ethanol (7)

II. Operations That Merely Dehydrate Cheap, Subsidized European Wine Alcohol Have Circumvented The Duties On Imported Ethanol, Generating Huge Profits And Reaping The Benefits Of Federal Tax Incentives That Were Intended Solely To Support The Domestic Industry, But Providing No Meaningful Economic Benefits To The CBI Countries In Which They Are Located. (8)

A. The CBI (8)

1. Purpose: economic development (8)

2. Duty-free importation (8)

B. The CBI Has Been Used As A Loophole To Reap Huge Profits By Importing Dehydrated Cheap European Wine Alcohol Duty-Free. (8)

1. U.S.C.S. Ruling: dehydration of wet alcohol qualifies for duty-free importation under C.B.I. (8)

2. Loophole: avoids duties by coming through CBI, then receiving U.S. tax incentive benefits. (9)

3. Dehydration facilities quick & cheap to build (10)

4. Cheap, heavily subsidized, European wine alcohol (11)

5. Dehydrators' profits (12)

C. Alcohol Dehydration Operations Do Not Materially Benefit CBI Countries, And Not Only Do Not Lead To Development Of Full Fermentation Facilities That Use CBI Feedstocks, But Actually Deter Development Of Same. (14)

1. Full fermentation presently in CBI region (14)

2. Full fermentation enhances CBI economies, whereas dehydration-only ethanol production does not. (15)

3. Ethanol produced from full fermentation of sugar cane, for export to U.S., is uneconomical at present world sugar prices, but could be economical for use as fuel within CBI countries. (19)

4. Dehydration-only production deters development of full fermentation facilities. (19)

III. Congress Closed The CBI Loophole By Imposing Indigenous Feedstock Requirements, And Gave The Dehydrators Ample Time To Recoup Their Investments And/Or Expand To Full Fermentation Operations. (20)

A. Indigenous Feedstock Requirements Imposed By The Tax Reform Act Of 1986. (20)

B. Existing Dehydrators Were Granted Temporary Exemptions From The Indigenous Feedstock Requirements, Giving Them Ample Time To Recoup Their Investments And/Or Expand To Full Fermentation Operations. (22)

1. Exemptions from indigenous feedstock requirements (22)

2. Grandfathered companies

(a) Tropicana (23)
(b) BioCom/CFC (26)
(c) Allied (29)
(d) LAICA (30)
(e) Petrojam (32)

IV. Re-opening The CBI Loophole Would Undermine The Domestic Ethanol Industry, And Potentially Imperil The $2.5-billion Investment Therein For The Sake Of Helping Five Trading Companies Whose Investments In The CBI Are Minimal. (34)

CONCLUSION (40)

SUMMARY

This report is about two federal legislative programs that were adopted by Congress to achieve different but entirely consistent objectives, and how a statutory loophole has been used to make the two programs work at cross purposes for the benefit of a few trading companies. Although Congress recognized and closed the loophole in 1986, the same interests that richly benefited from it are now working to have it re-opened and made permanent.

First, Congress passed the Energy Tax Act of 1978 to encourage and facilitate the development of a domestic industry for the production of ethanol as an alternative fuel additive. Congress exempted gasolene-ethanol blends containing ten percent ethanol ("gasohol"), from the gasoline excise tax, recognizing that the use of ethanol would: (1) strengthen our agricultural economy by significantly enhancing utilization of corn, from which ethanol is made; (2) reduce our dependence on foreign energy supplies; (3) improve the nation's balance of trade; and (4) enhance job creation directly in the agricultural products processing and related industries and indirectly in other sectors of the economy. Obviously, these advantages inure only from use of domestically produced ethanol from domestic feedstocks. Thus, Congress imposed duties on imported ethanol that precisely offset the excise tax exemptions for gasohol. (Further, while not a principal original impetus for promoting ethanol, it has subsequently been established that ethanol as a fuel additive has significant environmental advantages.)

The second program is commonly known as the Caribbean Basin Initiative ("CBI") which took effect on January 1, 1984. The CBI permits duty-free importation of products and materials from specified countries in the Caribbean Basin area, on the premise that expanding CBI countries' export markets will enhance economic and social development, and thus political stability, within the region.

The loophole that has been used to set these two programs at cross purposes is quite simple. A few companies built inexpensive plants in CBI countries to dehydrate hydrous alcohol (containing 10% water) to make anhydrous (water-free) ethanol, and began buying cheap surplus European wine alcohol production of which is heavily subsidized by several European governments. Such alcohol, which would be subject to 3% ad valorem and 60-cents per gallon duties if imported to this country directly, just passes through the CBI to have the water removed, and is then brought to the United States duty free to compete with domestically produced ethanol, enjoying the benefits of the Energy Tax Act's tax exemptions.

Since the dehydration capacity in CBI countries is approximately 215 million gallons per year, avoidance of just the 60-cents duty represents a loss to the U.S. Treasury of $129 million per year. This process would be bad enough if its consequences were limited to federal revenue loss and the inevitable undermining of the domestic ethanol industry. Worse, some CBI dehydrators have made enormous profits (covering their capital investments in a matter of months), and have not only made little appreciable contribution to the CBI economies, but actually have retarded the development of full fermentation ethanol production facilities in the CBI region that would use indigenous feedstocks such as sugar cane and provide substantial capital investment and employment.

Congress recognized this loophole, and included provisions in the Tax Reform Act of 1986 to close it. Specifically, Congress required that ethanol imported from the CBI contain minimum percentages of CBI-indigenous feedstocks by value: 30% in 1987, 50% in 1988, and 75% in 1989 and thereafter. These indigenous-content requirements were established to induce the dehydration-only companies to invest in full fermentation plants capable of making ethanol from domestic CBI feedstocks. Several of the existing dehydrators, however, persuaded Congress to "grandfather" them through 1988, and their exemption from the above requirements was extended through 1989 by the Omnibus Trade Act of 1988.

Now, the dehydrators are seeking to have the indigenous feedstock requirements abolished altogether, which should not be done. Ethanol production from CBI feedstocks is the type of economic development that the CBI was intended to encourage. If such ethanol can be produced and imported duty-free, it would not enter this country at prices low enough to disrupt the domestic ethanol market. Ethanol that is produced simply by de-watering cheap, heavily subsidized European wine alcohol, however, does virtually nothing for the CBI and has the potential seriously to threaten the domestic ethanol industry and undermine new value-added markets for grain that are so important to the United States. The dehydrators have had more than ample opportunity to profit from the loophole, which will remain open to them through 1989. The loophole should not be re-opened, and the existing dehydrator's grandfather exemptions should not be extended beyond 1989.

I.

Federal Tax Incentives Were Adopted Solely To Promote A Domestic Ethanol Industry Using Domestic Feedstock Sources.

During the 1970's, the United States Congress and many state governments recognized the desirability of promoting the development of ethanol as an additive for blending with gasoline ("gasohol"), perhaps the most important aspect of the nation's alternative fuels program. Numerous studies, such as the 1987 National Panel on Ethanol Cost Effectiveness and the recent Congressional Research Service analysis of ethanol's costs and benefits,[1/] strongly endorse government efforts to promote ethanol.

The establishment of a strong domestic fuel ethanol industry and the use of gasohol by motorists serves essentially four principal national interests: (1) increased demand for corn, from which most domestic ethanol is made, helping the agricultural economy and reducing the cost of federal farm programs; (2) improving the United States balance of trade by reducing demand for imported oil; (3) enhancing energy security by reducing dependence on foreign oil; (4) increasing employment directly in the agricultural products processing and related industries and indirectly in other sectors of the economy; and (5) improving the environment through use of an environmentally benign octane enhancer that has been proven to reduce carbon monoxide by up to thirty percent.

The United States Energy Tax Act of 1978 comprises the Federal Government's principal long-term commitment to encouraging and supporting a strong fuel ethanol industry in the United States. Initially, motor fuel consisting of a blend of

---

1/ Renewable Fuels Ass'n, Pre-hearing Statement To Internat'l Trade Comm'n, Oct. 20, 1988, p. 6.

ten percent ethanol and ninety percent gasoline (gasohol) was exempt from the 4-cents federal excise tax. Subsequently, the excise tax rose to 9-cents, and gasohol was provided a 6-cents per gallon exemption. Approximately thirty states determined to encourage the use of ethanol also, and adopted tax and other incentives toward that end.

The results of Federal and state ethanol incentives have been dramatic. Roughly $2 billion in private sector funds and $500 million in federal loan guarantees and commitments have been invested in the domestic ethanol industry, for the construction of plants and other facilities and the development of markets.[2/] Production of fuel ethanol in the United States grew from 20 million gallons in 1979 to a projected 850-900 million gallons in 1988.[3/]

Production of ethanol has significantly aided the American agricultural economy. As each 2.5 gallons of ethanol consumes one bushel of corn, the demand for corn for use in ethanol production has risen from 8 million bushels in 1979 to 340-360 million bushels in 1988. This means adding $1 billion to farm income in 1988 and reducing the cost of federal farm programs by $700 million (which more than offset losses in motor fuel excise tax revenues).[4/] It is estimated that ethanol production not only increases corn prices by 15-cents per bushel for each 100 bushels consumed, but also increases wheat values by 6-cents per bushel.[5/]

The use of ethanol as an alternative motor fuel additive has likewise cut American dependence on foreign supplies and reduced that element of the country's trade deficit. The projected production of 850-900 million gallons of ethanol in 1989 will displace approximately 31-33 million barrels of imported oil, and by-products from ethanol production provide an important source of high protein content food and feed exports. It is estimated that lower oil imports and higher agricultural exports have reduced the annual U.S. trade deficit by more than $700 million.[6/]

Obviously, the benefits for our agricultural economy, our trade balance, and our reduced dependence on foreign oil supplies are derived only from the use of ethanol that is <u>domestically</u> produced. <u>Importing</u> ethanol adds to the federal budget deficit, adds to the United States trade deficit, adds to the country's dependence on foreign fuel supplies, and displaces ethanol that otherwise would be made from domestic agricultural feedstocks. For these reasons, Congress did not intend the Federal tax incentives to apply to imported ethanol. Specifically, in order fully to offset the tax benefits insofar as they otherwise would apply to gasohol made from imported ethanol, Congress imposed a 40-cents per gallon tariff on imported ethanol, which had the

---

2/ Renewable Fuels Ass'n, Statement to Subcomm. On Trade, House Comm. On Ways & Means, Feb. 6, 1986, p. 408.

3/ Information Resources, Inc., Hearings Before Subcomm. On Oversight, House Comm. On Ways & Means, Feb. 27, 1986, p. 848.

4/ Renewable Fuels Ass'n, supra n.1, p. 6.

5/ National Ass'n of Wheat Growers, Statement to Subcomm. On Trade, House Comm. On Ways & Means, Feb. 6, 1986, p. 610.

6/ Renewable Fuels Ass'n, supra n.2, p. 375.

effect of exactly offsetting the 4-cents excise tax exemption for gasohol containing ten percent ethanol. An offsetting tariff was used in order to avoid the administrative burden that would have resulted if Congress had excluded gasohol containing imported ethanol from the excise tax exemption. When the excise tax exemption was raised to 6-cents, the tariff was raised to 60-cents.

II.

Operations That Merely Dehydrate Cheap, Subsidized European Wine Alcohol Have Circumvented The Duties On Imported Ethanol, Generating Huge Profits And Reaping The Benefits Of Federal Tax Incentives That Were Intended Solely To Support The Domestic Industry, But Providing No Meaningful Economic Benefits To The CBI Countries In Which They Are Located.

A. The CBI

The Caribbean Basin Economic Recovery Act ("CBERA"), commonly referred to as the Caribbean Basin Initiative ("CBI"), took effect January 1, 1984, and is to continue until September 30, 1995. Its purpose was to effect broad social change in CBI countries, by expanding duty free export markets for their products and commodities to the United States, so as to significantly increase employment and economic development. Thus, the CBI provides that eligible articles of commerce may be exported to the United States free of all import duties. In the case of fuel ethanol, the exemption is not only from the three percent ad valorem duty on all non-beverage ethyl alcohol (T.S.U.S. Item 427.88), but also from the 60-cents per gallon duty referred to above (T.S.U.S. Item 901.5).

B. The CBI Has Been Used As A Loophole To Reap Huge Profits By Importing Dehydrated Cheap European Alcohol Duty-Free.

In July, 1984, Tropicana Energy Co. requested a private ruling from the U.S. Customs Service that anhydrous (200-proof) ethanol produced by azeotropic distillation (dehydration) of hydrous (190-proof) alcohol in a CBI country, which was obtained from a non-CBI country, was eligible for duty-free importation into the United States under the CBI.[7] Azeotropic distillation is a fancy name for a very simple process. It consists of drying (de-watering) hydrous alcohol to make anhydrous ethanol, by adding benzene and heating the mixture, causing the benzene to vaporize and carry away most or all of the remaining water.[8] The Customs Service ruled that such dehydration of non-CBI hydrous alcohol in a CBI country was eligible for duty-free importation to the United States under the CBI.[9]

The result was creation of a glaring loophole in United States trade law, of which Tropicana and others were quick to take advantage. If foreign hydrous alcohol were imported into the United States for the purpose of dehydrating same and selling the resulting anhydrous ethanol in competition with the domestic industry, the imported product would be subject to the 3% ad valorem and 60-cents/gallon duties. But by transhipping wet wine

7/ Letter dated July 19, 1984, reprinted in Hearings Before Subcomm. on Trade, supra n.2, p. 499.

8/ Renewable Fuels Ass'n, supra n.2, p. 379.

9/ Letter dated Sept. 12, 1984, reprinted in Hearings Before Subcomm. On Trade, supra n.2, p. 515.

alcohol through a CBI country for mere dehydration and then exporting the ethanol to the United States, the dehydrated wine alcohol receives all the benefits of the gasohol tax incentives that were adopted solely to promote a domestic industry using domestic feedstocks, while avoiding the very duties that were adopted specifically to offset the tax incentive benefits that would inure to gasohol made from imported ethanol. Moreover, with a 215 million gallons per year capacity, the dehydrators avoid paying the U.S. Treasury some $129 million each year.

Dehydration facilities can be and have been constructed in the CBI quickly and cheaply. This is especially true where they are located on land already having available infrastructure such as storage tanks - as was the case for Tropicana and Petrojam in Jamaica, BioCom/CFC on St. Croix, and the dehydration facility at Punta Morales, Costa Rica.[10/] Whereas a full fermentation plant would require two years to build, a dehydration-only plant can be put up in three to six months.[11/] The typical capital investment in a 20 million gallons per year dehydration plant is estimated at between $3.5 million and $5 million, as compared to the $35 million cost of a full fermentation facility in the CBI area.[12/]

The Kingston Free Zone Application Form submitted by Tropicana reflected a total capital investment in its dehydration plant of $3,922,800.[13/] Representatives of Petrojam have told the Congress that construction of that company's dehydration plant and infrastructure cost $4 million.[14/] BioCom/CFC assigned a capital cost of $5 million to its dehydration facility.[15/] The cost of installing a dehydration tower at Punta Morales, Costa Rica, where all necessary infrastructure was already in place, is estimated to have been just a few hundred thousand dollars.[16/] These recent costs of constructing dehydration-only facilities in the CBI region should be compared to the cost of adding an alcohol fermentation and distillation facility to the CATSA sugar mill in Costa Rica in 1981 ($13 million)[17/] or the cost of the New Energy Company Indiana grass roots ethanol production plant in South Bend, Indiana ($185 million).[18/]

10/ F. Arechaga, Statement To Int'l Trade Comm'n, Oct. 27, 1988, p. 5.

11/ Downstream Alternatives, Inc., "Impact Of Dehydrated Ethanol From Carribean Basin Countries On The U.S. Fuel Ethanol Industry," Nov. 1987, p. 7.

12/ Renewable Fuels Ass'n, supra n.2, p. 385.

13/ Kingston Free Zone Co. Ltd., Application Form submitted by Tropicana Petroleum, Ltd., p. 4.

14/ T.B. Evans and H.J. Fenton, Letters dated Feb. 11, 1986, reprinted in Hearings Before Subcomm. on Trade, supra n.2, pp. 606, 636.

15/ BioCom Int'l, Ltd., Statement to U.S. Int'l Trade Comm'n, Oct. 27, 1988, p. 2.

16/ F. Arechaga, supra n.10, p. 5.

17/ Liga Agricola Industrial dela Cana de Azucar (LAICA), Statement to Subcomm. On Trade, House Ways & Means Comm., Feb. 6, 1986, p. 600.

18/ New Energy Co. of Ind., Statement dated Feb. 13, 1986, reprinted in Hearings Before Subcomm. on Trade, supra n.2,

(footnote continued)

The immediate profitability of alcohol dehydration is enormous because of the low capital investment that is required and the extraordinarily inexpensive non-CBI feedstocks that are available for that purpose. An estimated 500 million gallons of European wine have accumulated as a direct result of subsidies provided by the EEC and member national governments to grape growers and wine producers. Regulations requiring that surplus wine be sold to alcohol distillers have resulted in enormous supplies of wine alcohol, substantial portions of which have been sold below cost to dehydrators in CBI countries.[19] In September and November, 1984, Spain sold 36.6 million gallons of wine alcohol to Tropicana at an average price of 39-cents/gallon, compared to the Spannish government's cost of $5.21-6.26 to purchase, distill and store the product.[20] Equally cheap or cheaper wine alcohol has been sold by government agencies of Italy (10.5 million gallons in 1987, which cost $4.63/gal., sold for 26-cents/gal.) and France (10.5 million gallons in 1987, which cost $4.96-7.49/gal., sold for 40-cents/gal.).[21]

Most of the dehydrators' costs that are actually spent in the CBI (i.e., none of the foregoing) are attributable to the process of dehydrating.[22] Reasonable estimates of dehydration processing costs in the CBI range from 16-cents per gallon,[23] 17-cents per gallon,[24] to 18-cents per gallon.[25] The cost of shipping alcohol from Europe to the CBI ranges from 8 to 12-cents per gallon. Transportation of the dehydrated alcohol from the CBI to the United States gulf coast costs 4 to 5-cents. Thus, as the following table reflects, the dehydrators' estimated costs to produce one gallon of anhydrous ethanol by dehydrating European wine alcohol, and ship same to the United States, have ranged from 54.1 to 61.0-cents per gallon when Italian wine alcohol was used, and 67.0-cents to 74.0-cents per gallon when Spanish alcohol was used.

	Range of Costs Per Gallon of Ethanol			
	Italian alcohol		Spanish alcohol	
Non-CBI feedstocks	.260	.260	.390	.390
Transp. Europe to CBI	.080	.120	.080	.120

(footnote continued from previous page)
p. 617.

19/ Renewable Fuels Ass'n, supra n.1, pp. 10-11.

20/ Ibid., Appx. C.

21/ Ibid., Appx. D, E.

22/ In some cases, CBI dehydrators use a small amount of indigenous CBI feedstock, as may be necessary to meet the 35% value-added requirement of the CBERA. LAICA, Statement to U.S. Internat'l Trade Comm'n, Oct. 27, 1988, p. 3. See n.34, infra.

23/ Greater Rockford Energy & Technology Corp., Letter dated Feb. 7, 1986, reprinted in Hearings Before Subcomm. On Trade, supra n.2, p. 588.

24/ Renewable Fuels Ass'n, supra n.2, p. 381.

25/ Alcohol Week, Jan. 4, 1988, p. 10.

Processing	.160	.180	.160	.180
Transp. to U.S. gulf coast	.040	.050	.040	.050
	.540	.610	.670	.740

Ethanol prices in the United States follow fluctuations in gasoline prices. In 1985, the average price of ethanol in the United States was $1.47 per gallon.[26/] As discussed below (pp. 25-26), Tropicana was able to make a profit on its first contract for Spanish wine alcohol (30 million gallons) of approximately 57-cents per gallon, or $17.1 million on just that one contract. Since Tropicana's dehydration capacity is 20 million gallons per year, the profit on its first contract covered the $4 million cost of Tropicana's plant in just a few months.

United States prices of ethanol have declined from 1.47/gal. in 1985, averaging $1.01/gal. in 1986, $1.06/gal. in 1987, and $1.07/gal. during the first half of 1988.[27/] Even at these lower ethanol prices, the costs in the above table reflect a range of profits from 27-cents/gal. (1.01 minus .74) to 53-cents/gal. (1.07 minus .54).

Because dehydrators in CBI countries have access to hundreds of millions of gallons of inexpensive European wine alcohol feedstocks and can tranship fuel grade ethanol derived therefrom to the United States duty-free, the profitability of such operations is so large that they have been able to recoup their capital investments in less than one year.

C. Alcohol Dehydration Operations Do Not Materially Benefit CBI Countries, And Not Only Do Not Lead To Development Of Full Fermentation Facilities That Use CBI Feedstocks, But Actually Deter Development Of Same.

Many CBI countries produce sugar cane, which is an excellent, proven feedstock for the production of ethanol. Full fermentation plants annexed to existing sugar mills can ferment, distill and dehydrate ethanol from sugar cane juice or blackstrap molasses (cane molasses containing 23.5 - 26.4% water and 48.5 - 53.4% total sugars). Less common because more costly, high test molasses and/or raw sugar also can be used for that purpose.[28/]

Full fermentation ethanol facilities have been installed in several sugar-producing CBI countries, which have both exported ethanol and used it domestically. The fuel ethanol distillery annexed to the Palo Gordo sugar mill in Guatemala (4,000 metric tons per day grinding capacity, operating 190 days per year) has a name plate capacity of 46,000 gal./day. In 1987, 671,756 gallons of ethanol were exported to the United States.[29/] El Salvador has three full fermentation fuel ethanol distilleries, with combined capacity of 67,350 gal./day and estimated annual

---

26/ F. Arechaga, supra n.10, p. 2.

27/ Id.

28/ Ibid., p. 3.

29/ Ibid., p. 13.

production of 13.47 million gallons. While El Salvador has exported some of its ethanol production, most has been used in its domestic blending program.[30] Costa Rica annexed ethanol-producing facilities to the CATSA and Taboga sugar mills in 1980 and 1986, respectively, which have a combined ethanol production capacity of 95,000 gal./day.[31] In addition to the foregoing, full fermentation facilities are in various stages of development in the Dominican Republic, Panama, Honduras and Haiti.[32]

Full fermentation facilities such as those described above typify the type of investment that the CBI was intended to encourage, since they create new alternative markets for sugar cane and significantly enhance employment. Dehydration plants, on the other hand, provide little or no benefit to the host countries. Production of ethanol in full fermentation facilities is an important source of employment, since it depends on agro-industrial activity which is very labor intensive. Dehydration plants provide very little employment and virtually none in the agricultural sector.[33] Whereas a 20 million gallon per year distillery annexed to a sugar mill creates 980 direct jobs and 415 indirect jobs, a dehydration-only plant could be operated efficiently with only 20 to 25 employees.[34] As Ricardo Kriete, president of El Salvador's ethanol company, stated to the Trade Subcommittee:

> Our production provides many jobs . . . from the worker in the sugar cane fields to the port personnel and thousands in between. . . . A dehydration facility does not employ a fraction of the country's domestic capital assets and jobs that a grass roots facility does.[35]

Further, dehydration facilities that use imported feedstocks are not sources of foreign exchange for the host countries, as they are operated in "duty free zones". Not only do the dehydrators escape payment of import/export taxes by being in duty free zones, their tax liabilities to the host countries are minimized by exemptions. Nor does the dehydration process require major purchases of local supplies, or require significant use of local banking, insurance or transportation services.[36]

30/ Ibid., p. 12.

31/ Ibid., p. 11.

32/ Renewable Fuels Ass'n, supra n.2, p. 378; Alcohol Update, Jan. 16, 1989, p. 6.

33/ Dehydration plants sometimes add a small amount of local feedstock, such as alcohol made from sugar cane, to the wine alcohol that they use, in order to reach the 35% value-added requirement of the CBI. Since most of the local value-added requirement is satisfied by processing and administrative expense, the significance of local feedstock utilization is very minor. Moreover, it has no appreciable job creation effect, since the material is largely feedstock that is diverted from the industrial alcohol market.

34/ F. Arechaga, supra n.10, pp. 18-20.

35/ R.H. Kriete, Statement to Subcomm. On Trade, House Ways & Means Comm., Feb. 6, 1986, pp. 383-84.

36/ F. Arechaga, supra n.10, pp. 18-19.

When the price of ethanol in the United States was relatively high, it was feasible for CBI countries that produced ethanol from indigenous feedstocks to export a portion of their production to the United States. Thus, devoting a portion of a country's sugar cane harvest to ethanol production for export was economical as recently as 1985, when the world market price of sugar was under 6.5-cents/lb. and the price of ethanol in the United States averaged $1.47/gallon.[37] In recent years, however, world petroleum prices have declined and United States ethanol prices have followed the resulting drop in gasoline prices. Consequently, the export value of ethanol has become significantly lower than the cost of producing same from indigenous feedstocks in the CBI.[38]

One metric ton of raw sugar will produce 142.8 gallons of ethanol (i.e., 15.44 lbs./gal.). With the current world sugar market price of 9.75-cents/lb., exporting ethanol would be economical only at a price of $1.50/gal. or more, which is not possible at present.[39] The loss that would accrue is even greater if measured against U.S. quota, Lome ACP, or domestic sugar prices in CBI countries.[40] Similarly, ethanol derived from blackstrap molasses would have to bring $1.26/gal. in order to be economically exported to the United States.[41]

Several CBI countries have expanded their programs for domestic use of blended fuels containing ethanol produced from indigenous feedstocks. For example, El Salvador's first facility for ethanol production was annexed to its El Carmen sugar mill in 1983, having a capacity of 16,000 gallons per day, from which ethanol was exported to the United States in 1985 and 1986. Subsequently, the government adopted a domestic ethanol blending program, and expanded ethanol production capacity at El Carmen and other sugar mills to a total of 100,000 gallons per day.[42]

In time, exportation of ethanol derived from indigenous CBI feedstocks may again become economically feasible, if gasoline prices increase, the value of ethanol relative to gasoline increases, and/or the value of sugar cane declines.[43] Full fermentation plants attached to CBI sugar factories could continue to produce ethanol for domestic use, expand same for export to the United States, and switch production proportionally between sugar and ethanol as current economies dictate.[44] It is clear, however, that permitting duty-free importation of ethanol that is produced essentially from cheap, subsidized European wine alcohol will deter, not promote, the development of a full fermentation ethanol industry.

37/ Ibid., p. 17.

38/ Id.

39/ Ibid., pp. 6-7.

40/ Id.

41/ Ibid., p. 7.

42/ F. Arechaga, "Economic And Social Impact Of Fuel Ethanol Production In CBI Countries," Nov. 11, 1988, pp. 1-2.

43/ J.G. Reilly, Post-hearing Submission To Internat'l Trade Comm'n, Nov. 15, 1988, p. 1.

44/ W. Maloney (Tropicana's managing director), quoted in Alcohol Week, Dec. 26, 1988, pp. 11-12.

Unfortunately, the ability of a few entrepreneurs to import cheap European wine alcohol to the CBI and dehydrate same at low cost and high profit to themselves retards development of an indigenous-feedstock ethanol production industry that would provide substantial and meaningful economic benefits to CBI countries. This point was made repeatedly by CBI government officials and businessmen familiar with the region's agricultural, sugar and ethanol industries. Mr. Kriete of El Salvador explained that dehydration plants in sugar producing countries drain capital from other domestic investments and occupy existing infrastructure, thereby creating "an avoidance rather than incentivize the construction of additional grass roots facilities."45/

A statement of the El Salvador government, submitted by a special advisor to its sugar agency INAZUCAR, stressed that importation of alcohol for dehydration "should be viewed in its long-term effect," as it "detracts from the economic incentives of the CBI legislation". Thus:

> We fear that an uncontrolled proliferation of dehydration-only alcohol plants in the region with little or no utilization of raw materials produced in the CBI countries represents a serious threat that could defeat the very purpose of the . . . CBI legislation.46/

The same point was made by the vice president and manager of E.F. Hutton & Co.'s Latin American Sugar Department:

> . . . it is very difficult to economically justify investments in full scale ethanol plants as long as the ability exists for dehydration facilities to qualify for CBERA treatment . . . [which] has had a chilling effect on the development of this new industry in the Caribbean Basin. . . . Indeed, the economic realities are so overwhelming that . . . unless legislation to close this loophole is enacted, many of the promising new investments in the CBI ethanol industry will never be realized.47/

III.

Congress Closed The CBI Loophole By Imposing Indigenous Feedstock Requirements, And Gave The Dehydrators Ample Time To Recoup Their Investments And/Or Expand To Full Fermentation Operations.

A. Indigenous Feedstock Requirements Imposed By The Tax Reform Act Of 1986

The Customs Service's "substantial transformation" ruling opened a glaring loophole in the CBI. Tropicana and others were able quickly to build dehydration facilities in CBI countries,

---

45/ R.H. Kriete, supra n.35, pp. 383-84.

46/ C. Escamilla, Statement To Subcomm. On Trade, House Ways & Means Comm., Feb. 6, 1986, p. 586.

47/ R.A. Perez, Statement To Subcomm. On Trade, House Ways & Means Comm., Feb. 6, 1986, pp. 394-95.

purchase cheap subsidized surplus wine alcohol from Europe, and reap huge profits selling ethanol in the United States -- taking advantage of the tax incentives that were intended to apply only to domestically-produced ethanol and escaping the 3% and 60-cents duties that would have applied if the European wine had been imported into the United States directly. While reaping huge profits for the dehydrators, their activities produced little or no benefit for the countries that the CBI was intended to benefit.

Congress readily recognized that this development was contrary to its intentions in several respects. It had not intended that cheap, subsidized European wine alcohol enter this country without paying duties, and be sold as an additive for motor fuel qualifying for tax exemptions that were designed to apply only to the very domestic ethanol that the imported product was bound to displace. Nor had Congress intended the CBI to benefit a handful of entrepreneurs without creating meaningful investment in CBI countries. Thus, Congress included provisions in the Tax Reform Act of 1986, requiring that duty-free imports of fuel ethanol under the CBI contain minimum portions of indigenous CBI feedstock: 30% in 1987, 60% in 1988, and 75% in 1989 and thereafter. These requirements were imposed specifically to exclude dehydration-only operations from the benefits of the CBI.[48/]

B. Existing Dehydrators Were Granted Temporary Exemptions From The Indigenous Feedstock Requirements, Giving Them Ample Time To Recoup Their Investments And/Or Expand To Full Fermentation Operations.

While the Tax Reform Act was under consideration in 1986, three companies (Tropicana, Chemical Fuels Corp. and Allied Ethanol & Fuel Corp.) claimed that they had invested in the construction of dehydration facilities in reliance on the law as it existed in 1985 -- specifically, in reliance upon rulings of the U.S. Customs Service that anhydrous ethanol made by dehydrating hydrous wine alcohol was eligible for duty free importation under the CBI. Thus, these dehydrators claimed that they required limited time to continue processing European wine alcohol in order to recoup their investments and/or expand their operations to include facilities for production of alcohol from CBI-sourced feedstocks.[49/] Therefore, Congress included "grandfather" provisions in the Tax Reform Act, exempting from the indigenous feedstock requirements 20 million gallons of ethanol per year for three facilities through 1988. The Omnibus Trade Act of 1988 extended the grandfather provisions through 1989, and applied them to two additional plants (Petrojam of Jamaica, and the LAICA plant at Punta Morales, Costa Rica).

Now, some three years later, the same dehydrators continue to insist that their investments are in jeopardy, and that minimum indigenous feedstock requirements should be eliminated entirely. The dehydrators' pleas for sympathy are utterly

---

48/ H. Conf. Rep. No. 841, 99th Cong., 2nd Sess. II-1, 1986 U.S. Code, Cong. & Admin. News 4219-20; H.R. Rep. No. 426, 99th Cong., 2nd Sess. 225 (1986); Staff of Jt. Comm. on Taxation, 99th Cong., 1st Sess., Gen'l Expl'n of the Tax Reform Act of 1986, JCS 10-87 (Comm. Print 1987).

49/ Allied Ethanol & Fuel Corp., Ltd., Chemical Fuels Corp., Tropicana Petroleum, Ltd., Statements To Subcomm. On Trade, House Comm. On Ways & Means, Feb. 6, 1986, pp. 490, 446-49, and 417, respectively.

groundless, and the facts are contrary to their position. In some cases, commitments to ethanol production by full fermentation were made before the Customs Service ruling, or even before the CBI was enacted. Moreover, the dehydrators have had ample time to recoup their investments in dehydration facilities many times over, having been granted relief from CBI-content requirements by "grandfather" provisions of the Tax Reform Act of 1986 and the Omnibus Trade Act of 1988. Actually, the Congress granted such relief in reliance on the dehydrators' assurances that they needed time to "backward integrate", i.e., to expand their dehydration facilities to full fermentation plants, which would use feedstocks derived from CBI sugar cane exclusively. Those assurances were dubious to begin with and have not come to fruition. In any event, dehydration towers have uses other than making anhydrous fuel ethanol from European wine alcohol (such as beverage and industrial alcohol).

Tropicana

Tropicana testified before the Subcommittee on Trade of the House Ways and Means Committee in February, 1986, that it invested in the Kingston, Jamaica dehydration facility in absolute reliance on existing law, specifically in reliance on the Customs Service's ruling.[50/] The testimony did not focus on just how much that investment was, nor did it disclose that Tropicana was able to recoup it in its first seven months of operation. Rather, one month later, Tropicana wrote to the full Committee, proclaiming Tropicana's objective of using 100% CBI-sourced feedstock by 1990, specifically claiming that Tropicana would: (1) build a fermentation and distillation plant in Belize, to use locally produced molasses and surplus sugar, hopefully to commence by the 1987-1988 cane season; and (2) obtain a rum distillery in St. Lucia to produce alcohol from CBI molasses, beginning with the 1986-1987 season.[51/]

Under the Tax Reform Act of 1986 and the Omnibus Trade Act of 1988, Congress exempted Tropicana from any minimum CBI feedstock requirement through 1989, giving the company even more time to make money and backward integrate than it had requested. Tropicana had no reason to expect any more time and has done nothing in reliance on such an expectation.

Two and one-half years after its Congressional testimony, Tropicana was represented at a hearing before the International Trade Commission. Tropicana did not report on its progress in replacing European wine alcohol with CBI-sourced feedstocks or in making the acquisitions that it had forecasted in early 1986. Instead, Tropicana reiterated its plea that it had risked its savings by investing in a dehydration facility in reliance on existing law, and insisted that imposition of any indigenous feedstock requirement by volume would render the company's investment "entirely . . . valueless".[52/]

Tropicana's suggestion that it stands to lose the value of its investment in a dehydration facility is absurd, partly because the plant could be used for purposes other than making

---

50/ Tropicana Petroleum Ltd., Ibid., pp. 411, 415.

51/ Tropicana Int'l (Jam.) Ltd., Statement Before Subcomm. On Oversight, House Comm. On Ways & Means, Feb. 27, 1986, pp. 828-31.

52/ Tropicana Energy Co., Inc., Testimony Before U.S. Internat'l Trade Comm'n, Oct. 27, 1988, pp. 98-99.

fuel ethanol, but most importantly because Tropicana more than recouped its investment long ago.

The truth is that even taking the highest cost figure, Tropicana recouped its entire capital investment in less than one year -- i.e., prior to Tropicana's above-referenced Congressional testimony. Tropicana's initial supplier of wine alcohol was the Spannish agency Fondo de Ordenacion Y Regulacion de Producciones Y Precios Agrarios ("FORPPA"), with which Tropicana entered into five supply contracts. The first such contract, dated September 6, 1984, was for 30 million gallons at 40-cents/gal. (with an option to buy 75 million gallons more at the same price by February 28, 1985). Tropicana claimed that its processing cost (exclusive of feedstock and transportation costs) was 36.5 cents/gal.[53/] Even accepting this figure, with shipping cost from Spain to Jamaica of 8.5 cents/gal. and 5 cents/gal. from Jamaica to the United States, Tropicana's costs associated with its first contract for Spannish wine alcohol were no more than 90-cents per gallon.

Therefore, as reflected in the following pro forma profit/loss statement, with an average selling price of ethanol in the United States of $1.47/gallon in 1985, Tropicana's profit just on its first Spannish contract would have been approximately $17.1 million (.57/gal. x 30 million gal.).

Sales price		$1.470
Transp. Jam. to U.S.		.050
Net sales price		$1.420
Feedstock	.400	
Transp. Eur. to Jam.	.085	
Operating cost	.365	
Cost of goods sold		.850
Net profit per gal.		.570
First contract	30 mm gal.	
Profit	$17,100,000	
Capital cost	3,922,800	
Profit per gal.	.570	
Gals. to recover captial	6,882,105	
Gals./month (20 mm÷12)	1,666,667	
Months to recover capital	4.12	

Even if Tropicana sold its ethanol well below the average 1985 price, its profit on just the first Spannish contract clearly exceeded its $3.9 million capital investment -- not to mention subsequent Spannish contracts and even cheaper Italian feedstocks. Thus, the Company's professed fears of losing the value of its investment, made in so-called reliance on the 1984 Customs Service ruling, are disingenuous to say the least.

BioCom/CFC

Chemical Fuels Corp. of Atlanta, Georgia ("CFC") is a wholly owned subsidiary of BioCom International, Ltd., an Australian company, having been acquired in June, 1987. In February, 1986, CFC submitted a statement to the Oversight Subcommittee in which it said that it was developing a full fermentation facility on St. Croix, U.S. Virgin Islands, that would produce ethanol from

53/ Tropicana Int'l (Jam.) Ltd., supra n.51, p. 826.

sugar cane juice, high-test molasses and possibly raw sugar, which was planned for completion at the end of 1986.[54] Two weeks earlier, CFC advised the Trade Subcommittee that: (1) CFC's distillation facility would be operable around April 1, 1986; (2) CFC would have to dehydrate imported (i.e., non-CBI) alcohol while the fermentation plant was under construction; and (3) the "entire A to Z fermentation facility" would be completed by the end of 1986.[55]

A 1987 "Letter to Shareholders" issued by BioCom,[56] concerning its acquisition of CFC, told a fuller and somewhat different story. BioCom described "CFC's Business Plan" as contemplating construction of a "50 million gallon dehydration . . . facility on St. Croix . . . which it is intended will ultimately be extended to provide for the full fermentation of ethanol from either sucrose (a sugar derivative) or dextrose (a corn derivative). (p. 4 emphasis added). Further BioCom said that the site would be leased and already had the necessary infrastructure, so that the capital investment would be only 42-cents per gallon of annual capacity (i.e., .42/gal. x 50 million gal. = $21 million) (p. 5) The letter indicated that feedstocks would come from Europe and/or Brazil (not from the CBI). (p. 6) Even if CFC's processing costs were the same as Tropicana's (although its larger plant should be more efficient), and if its European feedstock costs were the same as Tropicana's first Spanish contract (although subsequent Italian wine was cheaper), the resulting profit rate of 25 cents per gallon would mean an annual profit for CFC at full capacity of $12.5 million.[57] At that rate, CFC could have recouped its capital investment in the entire facility (not just the dehydration portion) in less than two years.

In reliance on CFC's representations that its dehydration facility would come onstream around April, 1986, and its full fermentation facility would be completed by the end of 1986, Congress exempted CFC from the Tax Reform Act's CBI-feedstock requirements for one year, through 1987, and the Omnibus Trade Act extended the exemption for 20 million gallons through 1989.

Apparently it was the Congress that was mislead into relying on CFC's representations, rather than vice versa. As of February, 1988, not even CFC's dehydration facility, let alone its alleged fermentation plant, had commenced operation. CFC claimed that its dehydration plant would come on-line by April 1, 1988, and that full fermentation would begin by mid-year.[58] By August, however, the facilities were still unborn, CFC claiming that its plant was "95% complete" and that construction would "resume" as soon as the Omnibus Trade bill was signed.[59] By August 29, the dehydration portion reportedly was "97% complete", and it was "not certain" when the fermentation portion would be

---

54/ Chemical Fuels Corp., Statement To Subcomm. On Oversight, House Comm. On Ways & Means, Feb. 27, 1986, p. 855.

55/ Chemical Fuels Corp., supra n.49, p. 449.

56/ BioCom Internat'l Ltd., "Letter To Shareholders"; Appx. D to Renewable Fuels Ass'n, Post-hearing Submission To U.S. Internat'l Trade Comm'n, Nov. 15, 1988.

57/ Downstream Alternatives, Inc., supra n.11, p. 9.

58/ Alcohol Week, Feb. 22, 1988, p. 3.

59/ Alcohol Week, Aug. 8, 1988, p. 4.

finished.[60] In October, 1988, BioCom advised the International Trade Commission that CFC had spent $5 million on a dehydration facility the completion of which had receded to 95% -- without explaining what had become of BioCom's previously announced investment of $21 million in a full fermentation facility.[61] To date, CFC has not opened its plant and produced any ethanol whatsoever.

Allied Ethanol & Fuel Corp., Ltd.

Allied Ethanol & Fuel Corp., Ltd. ("Allied") is a joint venture comprised of Minneapolis, Minn., Baton Rouge, La., and Kingston, Jamaica interests. In a statement to the Trade Subcommittee in February, 1986, Allied stated that it was constructing an alcohol dehydration facility in an unidentified CBI country, in reliance on the CBI and the Customs Service's ruling.[62] Like Tropicana, Allied was grandfathered under the 1986 Tax Reform Act through 1988, and was granted a further extension through 1989 by the Omnibus Trade Act of 1988. Thus, Allied was given ample time to recoup its investment in dehydration (it did not ask for more), and to expand into full fermentation if it so chose.

Allied apparently chose not to take advantage of the exemption granted by the Tax Reform Act. In May, 1988, Allied announced that it would begin production at its 42 million gallon capacity Grand Bahama facility in June, and that while 20 million gallons were exempt from the CBI-content requirements of the Tax Reform Act, it would ferment its own alcohol locally to meet the 60% requirement for the remainder of its production.[63] In August, 1988, Allied said that construction of its facility had been "on hold" pending passage of the Omnibus Trade Act, and that it was then "a few weeks away" from completion.[64] To date, Allied still has not commenced production of ethanol.

LAICA

Liga Agricola Industrial dela Cana de Azucar ("LAICA") is a non-profit Costa Rican corporation that is governed by representatives of the government, private sugar mills, and cane growers. LAICA controls the export of all Costa Rican raw sugar and anhydrous ethanol production, at its tank terminal, loading facility, and distillation plant at Punta Morales.[65] In October, 1988, LAICA advised the International Trade Commission that:

> Costa Rica decided to diversify into ethanol production in the first place at the urging of the United States Government and only after receiving a letter ruling from the Customs Service confirming that upgrading the non CBI

60/ Alcohol Week, Aug. 29, 1988, p. 8.

61/ BioCom Int'l, Ltd., supra n.15, p. 2.

62/ Allied Ethanol & Fuel Corp., supra n.49, p. 490.

63/ Alcohol Week, May 9, 1988, p. 3.

64/ Alcohol Week, Aug. 8, 1988, p. 4.

65/ LAICA, supra n.17, p. 599.

hydrous ethanol constituted "substantial transformation".[66]

Actually, Costa Rica's commitment to production of ethanol substantially pre-dates the CBI and Customs Service rulings, and involves more than mere dehydration of non-CBI alcohol. A fermentation and distillation plant was annexed to Costa Rica's CATSA (Central Azucarera Tempisque SA) sugar mill in 1981, having an anhydrous ethanol capacity of 80,000 gallons per day.[67] A similar distillery was added to Costa Rica's Taboga sugar mill in 1986, with a capacity to produce 32,000 gallons of anhydrous ethanol per day.[68] LAICA has exported ethanol from both facilities, made from Costa Rican feedstock, to the United States duty-free under the CBERA, which meets the local-content requirements.[69] In addition, LAICA supplies "wet" alcohol to other dehydrators in the CBI, which is derived from Costa Rican feedstocks.[70]

Clearly, Costa Rica was committed to the production of ethanol from local feedstocks before adoption of the CBERA. When the CBI was established, Costa Rica produced ethanol for export to the United States as well as for domestic use. The only aspect of the Costa Rican ethanol industry that conceivably could have been undertaken in reliance on the belief that dehydration of European wine alcohol qualified for CBI benefits is the dehydration only facility at Punta Morales, which was built in a matter of months in late 1985-early 1986.[71] The bulk facilities for storage and shipment of alcohol from Punta Morales were already in place. Although LAICA opposed inclusion of indigenous feedstock requirements in the Tax Reform Act, it did not request a "grandfather" exemption as was afforded to Tropicana, CFC, and Allied. However, LAICA did obtain a "grandfather" exemption through 1989 under the Omnibus Trade Act of 1988. Significantly, LAICA has not claimed, let alone shown, either that it has not recouped its entire investment in the Punta Morales dehydration facility (alleged to be $6 million),[72] or that it cannot be used for purposes other than dehydration of European wine alcohol.

Petrojam

Petrojam is a wholly-owned subsidiary of the Petroleum Corporation of Jamaica, the state energy company of the Government of Jamaica. No representative of Petrojam or the Jamaican Government appeared before either the Trade or Oversight subcommittees while the indigenous feedstock provisions of the Tax Reform Act were under consideration in 1986. However, counsel for both entities wrote letters to the Trade Subcommittee, advising that Petrojam was investing $4 million for infrastructure and plant construction of a dehydration facility, for the purpose of making fuel ethanol for export to the United

---

66/ LAICA, Pre-hearing Submission To U.S. Internat'l Trade Comm'n, Oct. 20, 1988, p. 6.

67/ LAICA, supra n.17, p. 600.

68/ F. Arechaga, supra n.10, p. 11.

69/ Id.

70/ Id.

71/ LAICA, supra n.17, p. 601.

72/ Id.

States under the CBI.[73] The clear thrust of Petrojam's position was not that it intended to dehydrate non-CBI alcohol on a long-term basis, but that it would use Jamaican and other CBI-sourced feedstocks. Counsel for the Jamaican Government said that:

> The Government of Jamaica and the state petroleum company, Petrojam, is also committed to the development of a fully integrated ethanol project that will eventually utilize 100% Jamaican feedstocks.[74]

Both letters stated that Petrojam was rehabilitating the Bernard Lodge sugar estate for the purpose of supplying feedstock to the dehydration plant. The Trade Subcommittee was told that dehydration of non-CBI alcohol was just an "interim step," that by mid-1986, 9 million of the 40 million gallons of ethanol production would be supplied from Jamaican sources, and that in five years all of the feedstocks would come from Bernard Lodge.[75] Further, in 1987 Petrojam lease-purchased cane fields in Belize, and has expressed an intention to buy more of same in 1989.[76] Petrojam has announced plans to build a fermentation facility in Belize, to produce hydrous (wet) alcohol which would be shipped to its dehydration facility in Kingston, Jamaica.[77]

Since Petrojam claimed to be on a fixed course for the manufacture of ethanol from Jamaican and other CBI-sourced feedstocks, it did not seek and was not granted an exemption from the CBI-content requirements of the 1986 Tax Reform Act. It was, however, granted an exemption for 20 million gallons through 1989 by the Omnibus Trade Act. Petrojam's investment in ethanol facilities was not made in reliance upon an expectation that ethanol made from non-CBI feedstocks would remain eligible for CBI treatment, but was based on its plans to develop its own sugar fields to supply feedstocks for ethanol production.

IV.

Re-Opening The CBI Loophole Would Undermine The Domestic Ethanol Industry, And Potentially Imperil The $2.5-Billion Investment Therein For The Sake Of Helping Five Trading Companies Whose Investments In The CBI Are Minimal.

Notwithstanding the fact that Congress has already given the dehydrators more time than they needed (and more time than they originally requested) to recoup their investments and/or develop full fermentation facilities in the CBI region, they continue to seek elimination of any requirement that ethanol imported duty-free under the CBI contain a minimum percentage of indigenous feedstock. Obviously, their desire is to dehydrate as much European wine alcohol as possible and for as long as possible, taking advantage of tax incentives and other legislation that was

---

73/ T.B. Evans and H.J. Fenton, supra n.14, pp. 606, 636.

74/ Ibid., p. 606.

75/ Ibid., pp. 606-07.

76/ Petrojam, Ltd., Pre-hearing Brief Submitted to U.S. Internat'l Trade Comm'n, Oct. 20, 1988, p. 8.

77/ Alcohol Week, Feb. 22, 1988, pp. 1, 4.

intended to promote domestically-produced ethanol made from domestic agricultural products.

If the BioCom/CFC and Allied dehydration facilities are included, even without any further new construction or expansion the dehydration-only capacity in the CBI region is 215 million gallons per year. This capacity represents approximately 25% of current domestic ethanol production.

Even at present, the domestic ethanol industry is highly vulnerable, with ethanol prices depressed due to relatively low gasoline prices, feedstock prices high on account of drought-reduced supplies, and the repeal of some state ethanol incentives.[78] Moreover, the domestic ethanol market is largely saturated, even though production is below capacity.[79] The relative saturation of the U.S. ethanol market is attributable to several factors, including the facts that: (1) ethanol is not a perfect substitute for gasoline; (2) there has been widespread oil industry resistance to ethanol; (3) ethanol competes with other octane enhancers; (4) ethanol markets are state specific, in that the existence of a tax exemption or other incentive often determines whether ethanol is marketed in a given state; and (5) uncertainty as to continuation of incentives discourages investment in production and blending facilities and in other aspects of the overall ethanol marketing effort.[80]

The impact of a 20-22% supply increase in an already saturated market, particularly when the additional suppliers' cost structure permits significant price cutting, could be devastating to the domestic ethanol industry. A comprehensive study prepared for the United States Congress by Downstream Alternatives, Inc. demonstrates in detail the inevitable consequences of such an infusion of cheap CBI-produced ethanol. Most ethanol (about 86%) is sold in states that have adopted tax exemption incentives or producer incentives. Those state markets are fully developed (saturated), so the remaining 14% is sold in state markets that are marginal profit-wise at best. The lack of profitable new markets, coupled with ethanol price deterioration has capped growth of new ethanol production facilities and a number of such facilities have closed in recent years.[81]

First, increased supplies of ethanol derived from cheap European wine alcohol, dehydrated in the CBI region and imported into the United States duty-free, would lower ethanol prices generally. (The cost data set forth above reflect the margins for selling below current ethanol prices that the dehydrators enjoy.) A price reduction would not increase demand for ethanol, which is highly inelastic since a 10-cents/gal. reduction in the price of ethanol provides only a 1-cent cut in the wholesale price of a gallon of gasohol. However, a very small price advantage would suffice to induce blenders to switch to CBI suppliers, as ethanol is completely fungible.[82]

78/ W. Motes (Dir. of internat'l consulting, Sparks Commodities, Inc.), Testimony Before U.S. Internat'l Trade Comm'n, Oct. 27, 1988, p. 62.

79/ Ibid., p. 61.

80/ Downstream Alternatives, Inc., supra n.11, pp. 11-14.

81/ Ibid., pp. 14-15.

82/ Ibid., pp. 18-19.

Second, substantial supplies of low-cost dehydrated CBI ethanol would increase competition in the most attractive markets (i.e., those with state incentives) forcing ethanol supplied by producers least able to price-compete into less attractive markets, and ultimately displacing a volume of domestic ethanol altogether, resulting in plant closings. Downstream Alternatives estimates that the infusion of 100-150 million gallons of CBI ethanol (a low figure) would result in a price reducing ripple effect of 5-cents/gallon, and would cost domestic producers over $58 million in revenue per year, idling ten percent or more of operating United States production.[83]

Of course, the consequences of displacing a substantial volume of domestically produced ethanol are directly transferable to the agricultural sector. Even a conservatively estimated displacement of 100 million gallons of domestic ethanol would mean reduced consumption of 40 million bushels of corn (representing the equivalent of 330,000 acres and 1,300 farmers), and inevitably increase the governments' grain storage and price support costs.[84]

The dehydrators claim that their ethanol will not displace domestic production because it will be sold in presently undeveloped markets, principally along the East Coast, which they say are not served by the domestic ethanol industry because of high transportation costs from the Midwest, where most production is located. That contention is consistent neither with economic logic nor with history.

Transportation cost is not a significant impediment to marketing ethanol in coastal states.[85] As stated above, the principal factor that governs the development of ethanol markets is the existence of state incentives, which (except for Virginia) are not found along the Eastern Seaboard. The principle that ethanol will be sold where it brings the maximum profit applies just as well to the CBI dehydrators as it does to domestic producers. As the Downstream Alternatives study demonstrates, economic good sense dictates that CBI ethanol be directed to mature, developed markets capable of absorbing large-volume barge deliveries, having substantial sales volume and ample storage facilities.[86] The most economical approach for ethanol imported from the CBI is delivery to the United States Gulf Coast at New Orleans, for shipment by barge up the Mississippi River.[87]

Not surprisingly, it has been the mature developed markets, not the East Coast, to which cheap imported ethanol has gone in the past.[88] Tropicana's Kingston, Jamaica Free Zone Application expressed an intention to ship dehydrated ethanol to the U.S. gulf coast port at Houston, for redistribution to Tropicana's

---

83/ Ibid., pp. 20-25.

84/ S. Wentworth (President, Nat'l Corn Growers Ass'n), Testimony Before U.S. Internat'l Trade Comm'n, Oct. 27, 1988, pp. 57-59.

85/ A.E. Staley Mfg. Co., Statement To U.S. Internat'l Trade Comm'n, Oct. 27, 1988, p. 17.

86/ Downstream Alternatives, Inc., supra n.11, pp. 20-21.

87/ Id.

88/ New Energy Corp., Statement To U.S. Internat'l Trade Comm'n, Oct. 27, 1988, p. 48.

marketing terminals.[89] Those terminals are located in Texas, Tennessee, Illinois, Minnesota, Nebraska and Kansas -- not on the East Coast.[90] A marketing study for Allied contemplated large barge shipments of CBI ethanol via inland waterway to United States markets in Montgomery, Alabama; Houston, Texas; Paducah, Kentucky; and Indianapolis, Indiana. Almost all CBI ethanol has entered the United States through ports that could conveniently serve the midwestern states, as the following data reflect:

Percentage Of CBI Ethanol Imports By United States Ports Of Entry[91]

	1986	1987	Jan.-June 1988
New Orleans, LA	16%	68%	93%
Houston, TX	61%	--	--
Norfolk, VA	--	19%	7%
San Francisco, CA	11%	--	--
Baltimore, MD	4%	13%	--
Others	7%	--	--

Like their professed intentions to expand into full fermentation production of ethanol in the CBI region, the dehydrators' claims that their output will be sold in presently undeveloped markets is pure fantasy. A large volume of cheap ethanol produced by dehydration plants in the CBI would be sent directly to the already developed markets having the maximum state incentives, and a devastating impact on many domestic producers would be inevitable.

Moreover, even if ethanol dehydrated in the CBI were imported to and sold in East Coast states, it does not follow that the domestic industry would be unaffected. In the litigation involving duty-free imports of ethanol-tolune blends from Brazil, the United States Court of International Trade found that principal domestic producers of ethanol, such as A.E. Staley and Archer Daniels Midland: (1) market ethanol coast-to-coast and throughout the United States, and (2) were severely impacted by low-priced competition from the imported product in North Carolina and Florida, where it was sold. See, National Corn Growers Ass'n v. Baker, 636 F. Supp. 921, 930-40 (Ct. Int'l Trade 1986).

CONCLUSION

The Congressional programs for supporting a strong domestic ethanol industry that consumes American-grown agricultural products, and promoting meaningful economic development in the CBI region, are well conceived and deserve broad support. Importation of ethanol produced in the CBI region from indigenous feedstocks would enhance capital investment and employment in the area, without threatening the domestic ethanol industry.

89/ Supra n.13.

90/ SIGMA directory.

91/ U.S. Customs Service Form IM45; Petrojam, Ltd., supra n.80, Appx. B.

Duty-free importation of dehydrated European alcohol is just the opposite: it retards meaningful development in the CBI region and threatens significantly to displace American ethanol made from American feedstocks. The loophole that Congress closed in 1986 should remain closed, and the grandfather exemptions for a few dehydrators should be allowed to expire at the end of 1989.

Respectfully Submitted To
The United States Congress

By

The Corn Coalition

CHADWELL & KAYSER, LTD.
35 W. Wacker Dr., Suite 3300
Chicago, IL 60601-1698
(312) 419-7500

ADDENDUM

re

February, 1989 Reports Of
The International Trade Commission
and
The General Accounting Office

As required by Section 1910 of the Omnibus Trade and Competitiveness Act of 1988, the International Trade Commission instituted an investigation entitled "Ethyl Alcohol and Mixtures Thereof: Assessment Regarding The Indigenous Percentage Requirements for Imports in Section 423 of the Tax Reform Act of 1986", and issued its report in February, 1989 ("the ITC Report"). The statute also directed the General Accounting Office to study the same subject, and in February, 1989, the GAO issued its report, entitled "Fuel Ethanol Imports From Caribbean Basin Initiative Countries."

With respect to the Congress's specific question, whether the indigenous product percentage requirements of Section 423 are economically feasible for CBI ethanol producers, the ITC concluded that under recent market conditions, production of ethanol in the CBI for duty free export to the United States would be feasible only if indigenous feedstock requirements were below thirty-five percent by value, and that future feasibility will depend on future market conditions. (ITC Report, p. 5-25) With respect to the Congress's direction to recommend indigenous feedstock percentage requirements that would:

(a) ensure meaningful production and employment in the region, yet

(b) discourage pass-through operations and

(c) not harm domestic ethanol producers,

the ITC found that: "Because so many factors influence CBI ethanol exports, it is not possible to mandate a single feedstock requirement that will guarantee a CBI ethanol industry of any particular size that has a minimal effect on the U.S. ethanol industry." (ITC Report, p. 5-23)

The GAO inquiry produced essentially the same result. Finding that ". . . the several policy objectives of the [1988 trade] legislation are in conflict" (GAO Report, p. 37), the GAO made no recommendations, but described the "possible range of options [for indigenous feedstock requirements] available depending on the priorities of Congress." (Id., pp. 37-39)

These findings are directly responsive to the Congress's inquiry, and are consistent with several conclusions articulated in the Corn Coalition's report. However, the ITC report is somewhat misleading in that its focus on the Latin American sugar industry (which is not confined to the CBI) leaves the impression that the controversy surrounding ethanol imports from the CBI essentially involves ethanol produced from sugar cane feedstocks. That simply is not the case.

The importation of ethanol from the CBI would not be an issue were it not for one indisputable fact: the overwhelming preponderance of the ethanol that has been imported from the CBI has been derived from cheap, heavily subsidized European wine alcohol feedstocks which are simply dehydrated in the CBI, not

from sugar cane or other feedstock sources indigenous to the CBI. The dehydrators have worked tirelessly to avoid indigenous feedstock requirements for one clear reason: they want to use as much of the cheap, heavily subsidized European wine alcohol, and as little CBI-indigenous feedstock, as possible. What little of the latter that the dehydrators have actually used has been solely on account of minimum local value-added or feedstock requirements imposed by the original CBI legislation and amendments thereto.

The ITC's data show this clearly: "From 1985 through September, 1988, approximately 68 percent of the fuel ethanol imported from the Caribbean Basin countries was produced from surplus wine alcohol." (ITC Report, p. 3-3, emphasis added.) Some of the discussion in the ITC Report may leave an impression that is different from this inescapable fact. For example, the ITC observes that: "The primary feedstock used by the Caribbean ethanol industry to produce the nonindigenous portion of their fuel ethanol for export to the United States has been surplus European wine alcohol, the European 'wine lake.'" (ITC Report, p. 3-19, emphasis added.) Surplus European wine alcohol does not just comprise the "primary nonindigenous" feedstock; it is the overwhelmingly predominant feedstock for all CBI ethanol exported to the United States.

The ITC Report quotes some of the dehydrators to the effect that European wine alcohol has certain contaminants that add to the cost of processing, and that it is therefore "not an appropriate feedstock for the fuel ethanol producers to use in their azeotropic distillation columns." (ITC Report, p. 3-22) While the implication is that the dehydrators would prefer to use some other feedstock (presumably indigenous to the CBI), the opposite is true. Even though the purity of wine alcohol may not be ideal, the dehydrators actually use as much of the heavily subsidized European wine alcohol as possible, notwithstanding their alleged preferences, because any disadvantage in processing cost is completely outweighed by the feedstock's extremely low purchase price. It should be obvious that if the dehydrators really preferred to use CBI-indigenous feedstocks, they would not object so strenuously to legal requirements that they do so in order to qualify for duty-free importation under the CBI.

The ITC Report contains different sets of data on the dehydrators' feedstock costs that appear to be contradictory. Table F-15 (ITC Report, p. F-19) sets forth the dehydrators' cost of European wine alcohol, based upon official statistics of the Council of European Communities. With 1986 and 1987 exchange rates of $.9850 and $1.617 per ECU, respectively, the costs of European wine alcohol, F.O.B. and based on 100% alcohol content, were as follows:

	ECU/gal.	$/gal.
1986:		
Spain	.25	.2463
France	.29	.2857
Total EC	.29	.2857
1987:		
Spain	.44	.5111
France	.32	.3717
Italy	.18	.2091
Total EC	.24	.2788

The foregoing cost figures are consistent with the data reported in the Corn Coalition report (supra, pp. 11-13, 25-26), which

were derived from reports of the U.S. Embassy Agricultural Counselors in Madrid, Rome and Paris and were provided to the ITC by the Renewable Fuels Association (Prehearing Statement, Oct. 20, 1988, Appx. C, D, E) The above cost data show how inexpensive the heavily subsidized European wine alcohol truly is.

Unfortunately, the body of ITC Report seems to ignore the official cost data, and instead cites considerably higher dehydration feedstock costs without identifying any specific source therefor. The table at page 3-5 of the ITC Report purports to compare costs of full fermentation and dehydration only plants in CBI countries, and ascribes feedstock costs of 60-80 cents/gallon to the latter. If those figures are intended to pertain to the cost of the heavily subsidized European wine alcohol that is actually used by dehydrators in CBI countries, they are completely at odds with reality. Significantly, while the table is accompanied by a footnote explaining that the reported full fermentation feedstock costs were based on an assumed world market price for sugar, there is no explanation for the reported dehydration only feedstock costs, and it is obvious that the price of the heavily subsidized European wine alcohol that CBI dehydrators use is not affected by world sugar prices.

Another aspect in which the ITC Report is deficient is its treatment of the "ethanol industry" in the CBI region as a single economic phenomenon, whereas in fact the production of ethanol from full fermentation of indigenous feedstocks, and the mere dehydration of European wine alcohol, could hardly be more different. While the ITC Report recognizes that the principal economic significance of an ethanol industry is its creation of employment in the agricultural sector that supplies the feedstock,[1/] it does not sufficiently emphasize that while Caribbean Basin full fermentation plants use sugar cane feedstocks and therefore generate agricultural employment in the CBI region, dehydration only plants use mainly European feedstocks, and therefore only help to relieve the agricultural surpluses in Europe.

The GAO report, on the other hand, expressly acknowledges this fundamental difference, noting that the very reason why Congress imposed indigenous feedstock requirements in the Tax Reform Act of 1986 was its recognition that ". . . the CBI plants that relied primarily on non-CBI feedstock did not provide the type of economic development opportunities that justified preferential tariff treatment." (GAO Report, p. 22)

It is important to bear in mind that the CBI ethanol controversy is not just a tariff issue; it is a federal subsidy

---

1/ The ITC Report's citation of another alleged benefit to the CBI: "The [Tropicana dehydration] plant earns $10 million per year in foreign exchange for the Jamaican Government" (p. 3-12), is inexplicable. The Tropicana plant is in a Jamaican "duty-free" zone, escapes import/export taxes, and is not a source of foreign exchange to Jamaica. Moreover, the profits from dehydration are realized offshore -- i.e., either when an affiliated trading company buys the cheap wine alcohol in Europe and resells same to Tropicana International of Jamaica at an inflated price (which may explain the latter's alleged high costs), or when Tropicana Energy Co. (the parent) resells the ethanol that it purchases from Tropicana International of Jamaica (the subsidiary). See, F. Arechaga, Statement to I.T.C., Oct. 27, 1988, pp. 18-20.

issue as well. Unlike the ad valorem duty that would apply to many other imported products but for the CBI, the 60-cents per gallon duty on imported ethanol was imposed specifically for the purpose of precisely offsetting the 6-cents per gallon federal excise tax exemption for 90%-gasoline -- 10%-ethanol gasohol. As the GAO report states:

> Early on, Congress decided against subsidizing ethanol imported from another nation. In 1980, it instituted tariffs on imports of foreign ethanol to offset the federal subsidy which ethanol enjoys.

(GAO Report, p. 10) While the Congress has provided tax incentives to promote development of an ethanol industry in the United States, and has provided for duty-free importation under the CBI to enhance employment in the Caribbean Basin, the Congress has never identified any national interest in relieving agricultural surpluses in Europe or in subsidizing the trading companies who built dehydration only plants in the CBI region in order to take advantage of European surpluses.

The reports of both the ITC and the GAO refer to the dehydrators' claims that they invested in dehydration facilities in reliance upon the CBI, and take note of the fact that the Tax Reform Act and the Omnibus Trade Act "grandfathered" some of them from the indigenous feedstock requirements through 1989. (ITC Report, pp. 1-3 -- 1-4; GAO Report, pp. 22-23) Neither report, however, mentions the facts fully documented in the Corn Coalition report, that: dehydration facilities were relatively cheap to build; the dehydrators asked for time specifically to expand into full fermentation of indigenous feedstocks; and they were given ample time to do so and to recoup their investments in dehydration plants -- which some of them have done many times over.

Finally, the ITC Report refers to domestic and CBI ethanol as "imperfect substitutes" (p. 4-8), tending to minimize the potential impact that imports of dehydrated ethanol can have on the domestic United States ethanol industry and the agricultural economy to which the matter is of critical importance. The ITC apparently found that domestic and CBI ethanol were "imperfect substitutes" (although chemically fungible) because sixty percent of sales of domestic ethanol occurred in mid-western states, whereas most CBI ethanol was shipped to a few coastal states. Comparing the states in which domestic ethanol is actually sold with the states through which CBI ethanol enters the country is like comparing apples and oranges. The ITC Report overlooks the facts, set forth in detail in the Corn Coalition report (supra, pp. 38-40) that: (1) the coastal states to which CBI ethanol is shipped are mere ports of entry, with the product being readily shipped therefrom to the same areas where domestic ethanol sales are concentrated (principally up the Mississippi River from New Orleans); (2) like domestic ethanol, imported product is sold principally in states having tax incentives; and (3) since the domestic ethanol market is largely saturated, ethanol dehydrated in CBI countries and imported to the United States with a significant price advantage substantially displaces domestic production.

The ITC is correct in its observation that if minimum indigenous feedstock requirements for CBI ethanol are high enough to "discourage pass-through operations" and prevent harm to domestic producers, they will not also "ensure meaningful production and employment in the [CBI] region". That is true because: (1) under current world sugar and petroleum price

conditions, production of ethanol from indigenous feedstocks in the CBI for export to the United States is uneconomical; and (2) dehydration of cheap, heavily subsidized European wine alcohol in the CBI simply does not ensure meaningful production and employment in the region, but merely rewards the investors in the dehydration facilities. Thus, indigenous feedstock requirements have the benefits of discouraging pass-through operations and preventing harm to the domestic ethanol industry. Eliminating or significantly reducing such requirements would encourage pass-through operations and harm the domestic ethanol industry, but would not produce any material advantages for employment in the CBI region.

Chairman GIBBONS. Ms. Graf.

STATEMENT OF KATHLEEN GRAF, CHAIR, MINNESOTA ETHANOL COMMISSION, AND OWNER/OPERATOR, GRAF FEED & FUEL ALCOHOL, WATERTOWN, MN

Ms. GRAF. Thank you, Mr. Chairman, and you've got the last speaker, let's hope.

My name is Kathy Graf and I am actually wearing a few different hats as I sit here before you today.

I am chairman of the Minnesota Ethanol Commission, which was legislatively derived and the funding is from the Minnesota legislative body, to educate and promote about the use of ethanol in Minnesota.

We have had a very extensive program. We do education for mechanics, and reach out to the public, and prepare a marketplace for the entrance of and current use of ethanol in our State. Similar programs are with other States across the United States.

So, that direction is one direction that I come to you. I am also a producer of ethanol. We have a small facility, about a half million gallon size on our farm just outside of the Twin Cities in Minnesota. So that I have a practical knowledge of the production and marketing of ethanol even though it's on a small scale.

We are a private party who has made the investment and the commitment.

The third way that I can come to you is as a market development specialist for a company called International Biosynthetics, which is headquartered in Charlotte, NC. They are a supplier of enzymes to the starch processing industry. And my task with them is simply to assist the domestic ethanol industry to grow.

And through that, those three prospectives, there are a few comments that I would like to make that are very simple. They are just very practical. And also that is the direction where my comments are coming from so that it's a little bit different perspective than perhaps some of the things that you've heard so far that are also valid arguments.

And also I would like to comment that we heard very enthusiastically that there are going to be a lot of oxygenated fuel marketplaces opening up, and that ethanol will hold a hearty portion of that market. I hope that's all in the crystal ball and very clear because we need it.

I would also like to make the comment that one thing that disturbed me during the hearings today is that there were numerous references to the big daddy of ethanol production here in the United States, and comments also about the volume of incentives or subsidies that they have received.

I certainly hope that the rest of us who are into this industry have committed a great deal of our private money and time and public money and time, are not ignored or forgotten about in the hostility that I perceived toward that one large company who has received subsidies.

Chairman GIBBONS. I'm not hostile toward them. I don't know of anybody who is hostile toward them. When they have 60 percent of

the market, apparently they just say that somebody is appearing for them.

Ms. GRAF. That isn't my concern. My concern is there's another 40 percent being produced. Don't permit it to happen. We pay the price for the lack of desire to let them get exemptions and things like that.

Be cautious. We are there, and we are working very hard. And I don't want that to be ignored.

[The statement of Ms. Graf follows:]

MINNESOTA
ETHANOL
COMMISSION

90 West Plato Boulevard
St. Paul, MN 55107
Phone 612/297-4654
Fax 612/296-6890

Statement of

Kathleen Graf

Chair
Minnesota Ethanol Commission

and

Owner/Operator
Graf Feed and Fuel Alcohol
Watertown, Minnesota

before the

WAYS AND MEANS SUBCOMMITTEE ON TRADE

April 25, 1988

Introduction

Good morning. My name is Kathleen Graf and I am the Chair of the Minnesota Ethanol Commission. The Commission was established in 1987 by the state legislature as part of a decade long commitment to the development of a Minnesota ethanol industry that will have the potential to utilize Minnesota grain, create employment for Minnesota workers, stimulate economic development in our state and clean the air in our cities.

It may be of interest to the Committee that I also own and operate a small ethanol production facility on our family farm. We produce about 60 gallons per hour of very clean 199+ proof alcohol. Our molecular sieve anhydrous system is double capacity, thus enabling us to do custom upgrading of wet alcohol from other plants. In effect, the kind of dehydration that is the subject of today's discussion.

The reason I am here today is fourfold. First, to give you a clear understanding of the level of commitment and investment needed to develop an indigenous ethanol industry. These markets are not developed overnight. It takes years of education, promotion and preparation to assure the regulatory and marketplace environment which can support an ethanol industry. The State of Minnesota has made those investments and I, both as the Chair of the Minnesota Ethanol Commission and as a producer have been actively involved in this effort for six years.

Second, I would like to focus on the peculiar concept of what the Caribbean dehydrators have termed "backward integration." The Committee is likely to hear a great deal about the promises of the dehydrators to invest the profits from transshipped wine alcohol to "backward integrate" their facilities to full-fermentation, but I would like to ask, why in the last three and a half years that these companies have enjoyed the profits from transshipped wine alcohol have they failed to make any significant investment in full-fermentation? Why have they yet to produce a single drop of ethanol from raw agricultural feedstocks from the Caribbean? And interestingly, why is it that U.S. producer's struggling to obtain financing and build "forward intergration" facilities in this country are prohibited from utilizing a similar economic plan?

The answer to all these questions is simple - "backward integration" is nothing more than a ruse to line the pockets of savvy, politically connected trading companies, there is no incentive to re-invest in costly full-fermentation facilities and absolutely no public policy benefit derived from its use.

Third, the Minnesota Ethanol Commission is particularly concerned that this transshipped product will enter the market that we have worked so hard to develop, and make it virtually impossible for Minnesota producers to compete. Minnesota is an open exemption state with an established ethanol market. Therefore it is highly likely that the Caribbean investors, in seeking to maximize their profit potential as any sane businessman would do, will ship their product up the Mississippi River and into Minnesota stealing valuable markets from our producers and displacing grain that would have been used to produce ethanol.

Finally, the Minnesota Ethanol Commission sincerely believes that the development of an indigenous ethanol industry in the Caribbean Basin is a worthy policy goal and should be pursued. We are concerned, however, that the modification or elimination of any feedstock requirements will not accomplish this and, in fact, will only continue to encourage simple pass through operations that not only pass foreign ethanol through to the domestic market but which pass the benefits that could be accrued in the Caribbean to the foreign source of the feedstock.

We believe that in order to accomplish the stated purpose of the CBI - to create an indigenous ethanol industry in the Caribbean - other policy options must be explored. As long as the Caribbean ethanol industry remains a for-export-only program, the economics of producing ethanol will encourage pass through operations. Ethanol has always been based on the public policy benefits it delivers - agriculture, energy security, jobs and the environment. If those benefits are exported as well, there is no economic justification for supporting an ethanol program.

Minnesota's Commitment to Fuel Ethanol

Over the past eight years, the state of Minnesota has spent an average of $2 billion annually on transportation fuel it has had to import. At the same time, we have produced energy in the form of 700 million bushels of grain that is largely exported. In addition, much of the state was in non-attainment for carbon monoxide and ozone and did not meet EPA standards. Thankfully, state government leaders recognized that there was a ready solution to this ludicrous imbalance - ethanol. And an extremely enlightened decision was reached to aggressively promote the increased production and use of ethanol fuels.

With an executive order that all state vehicles be run on ethanol blended gasoline, Governor Perpich in 1983 established Minnesota's ethanol program. Since that time, numerous state sponsored education and promotion programs have been established to further the development of this industry.

- Development and distribution of "statement cards" for gasoline stations declaring preference for ethanol blends.
- Corn Day at the Dome. 10,000 bags with sweet corn and ethanol information given out at Twins games.
- Demonstrations showing no effects of ethanol blends on carburetor parts.

- Sponsor of Ethanol Enriched Team Polaris. A snowmobile team that runs at interstate races and educates snowmobilers that ethanol is safe for snowmobiles.

- Fleet vehicle programs for private businesses and counties. There are 18 counties currently using ethanol blends exclusively in their vehicles.

- Published "Ethanol Answer Book".

- Distribution of numerous promotional materials to educate consumers on the benefits of ethanol.

Perhaps our most successful promotion program, however, has been the creation of the "Ethanol Answer Man". This program began this year and requires a full-time person to work with the media; address civic, public and private groups, and schools; attend conventions; and educate mechanics on fuel quality issues that relate to ethanol blends. The "Ethanol Answer Man" travels the state in an "Ethanol Answer Van" that has attracted a great deal of positive attention.

In addition to these promotional efforts, the state has also aggressively sought statutory and regulatory incentives for ethanol producers. Minnesota provides a 20 cent per gallon payment to ethanol producers. A tax reduction credit of 2 cents per gallon of ethanol blended gasoline is available to distributors. This credit is available for ethanol "derived from agricultural products such as cereal grains, cheese whey, sugar beets, or forest products or other renewable resources." This exemption will provide an added incentive to Caribbean Basin dehydrating companies. The credit has no sunset date for expiration.

Finally, Minnesota provides an exemption from the RVP requirements for automotive gasolines that enables ethanol to be blended in the state. Without this exemption, ethanol would have to be blended with sub-RVP gasolines that are unavailable in the state.

The State of Minnesota is second to none in its commitment to the development of the domestic ethanol industry. And we are seeing the results. Plants have been built, investments have been made, jobs have been created, farmers have a new market for their grains, and the best is yet to come.

"Backward Integration"

Although they acknowledge that it is not economically feasible to produce fuel ethanol from indigenous feedstocks for export to the United States, the Caribbean dehydrators claim that their intent is to "backward integrate" into a truly indigenous ethanol industry which produces ethanol exclusively from local resources. They contend, however, that more time is needed in order to develop adequate sugarcane stocks dedicated to ethanol production and to build full-fermentation facilities. The Caribbean dehydrators have been making such claims since 1984, yet little, if any, progress has been made toward these purported objectives. Even today, they continue to be vague about when they expect to be able to establish full-fermentation ethanol operations which utilize indigenous feedstocks.

As I noted earlier, I am a producer of fuel ethanol. My husband and I invested in a "forward integration" full-fermentation facility capable of producing ethanol from corn because we understood that when Congress enacted the federal incentives to promote the development of the U.S. ethanol industry, the Congress clearly intended to promote the utilization of domestic agricultural feedstocks. In fact, every

major ethanol production industry in the world has practiced "forward integration". Brazil, Argentina, the United States, and even several Caribbean Basin nations have developed domestic production and marketing incentives designed to encourage the investment in ethanol production facilities capable of producing ethanol from raw agricultural feedstocks.

In my position as Chair of the Minnesota Ethanol Commission, as well as my position as a Market Development Specialist with International Bio-Synthetics, a supplier of enzymes to the starch processing industry, I am fully aware of efforts across the country to build "forward integration" ethanol production facilities. Through my association with IBIS, I am presently working with or assisting in one form or another 258,000,000 gallons of new production that wants to be constructed. In working with these potential new domestic facilities, which when in production will collectively increase our current production by 25 percent, the same three areas of concern about the future of the industry are brought forward by the lenders:

A). The extension of the six cent Federal Excise Tax Exemption.
B). The fact that the U.S. does not have a long term energy policy.
C). The future of imported duty free ethanol.

If the Congress were to allow these companies to "backward integrate" using duty-free EC wine alcohol, any one of these plants could be on line in a matter of weeks. But the Congress has correctly sought to encourage full-fermentation development and has prohibited U.S. companies from utilizing these feedstocks without paying the appropriate duty on imported ethanol. Thus, the Congress has granted five Caribbean trading companies a marketplace advantage it prohibits from domestic producers.

One such facility, for example, is North Carolina Ethanol Ltd., which intends to construct a sixty million gallon a year ethanol fermentation plant in Duplin County. The investors have already invested heavily of their own funds and time and energy for the past three years to bring the project to its current positive standpoint. The project will:

1) use $100,000,000.00 for the ethanol plant which will use corn as its feedstock;
2) use $110,000,000.00 on the additional co-generation plant and the co2 processing plant which are part of the project;
3) create between $800,000.00 and $100,000,000.00 per year in tax revenue;
4) create 200 - 600 jobs during construction;
5) employ between 125 - 150 people during operation paying approximately $2.500,000.00 out in payroll; and
6) have multitudes of positive spillover effects on the city, county and state.

It will be a major new industry. It also happens that they are locating themselves in an area which could be a likely marketing area for imported ethanol. The threat of Congress endorsing the continuance of duty free imported ethanol could undercut their market and kill the project instantly. Even if it sounds unpleasant and uncomfortable, Congress may have to realize that to support the coninued dehydration of EC wine alcohol through the CBI has the potential of killing this exciting new project and many others like it.

As long as the incentives to encourage the use of local feedstock are missing in the CBI, opportunists will continue to exploit the CBI for profit and there will be no major economic contribution to the Caribbean economy from legitimate ethanol producers. And as long as this marketplace advantage is accorded to Caribbean trading companies to the exclusion of domestic

producers, new investment in U.S. full-fermentation ethanol production capacity will be similarly discouraged.

Minnesota's Concerns Regarding CBI Dehydration

As you know, during the debate on the 1986 Tax Reform Act, the Congress held three separate hearings before making a determination to require ethanol facilities in the Caribbean region to utilize increasing levels of local sugar cane in the production of fuel grade ethanol for duty-free export to the United States. A transitional period was allowed for conversion of production to local feedstocks, to encourage capital investment and development of "grassroots", or full-fermentation ethanol facilities in CBI countries.

In last year's Trade Bill, however, several trading companies were granted the privilege to avoid any Caribbean Basin sugar cane content requirements through so-called "grandfather" exemptions. These exemptions will allow recipient companies to import heavily subsidized EEC wine alcohol into the U.S. after removing 5% water content in simple dehydration towers located in the Caribbean. This method for subverting the purpose and spirit of the CBI legislation will eliminate new cash markets for surplus sugar cane grown in the Caribbean Basin, decrease corn usage in the U.S. and increase federal farm program costs.

Allowing five private companies to operate ethanol dehydration only facilities in the Caribbean Basin without any requirements to utilize CBI produced sugar cane, will create serious economic problems for U.S. ethanol producers, American farmers and Caribbean Basin countries themselves. The most significant problems are as follows:

- Displace desperately needed markets for American corn--lowering farm prices and increasing federal farm program costs. (100 million gallons of EEC wine alcohol will eliminate a market for 40 million bushels of corn annually).
- Establish unfair competition with U.S. produced ethanol in long established ethanol markets -- driving down prices and stalling future U.S. industry growth. Investors will not choose to compete with another country's treasury.
- Eliminate a market for more than 250,000 tons of U.S. coal used in the production process of anhydrous ethanol.
- Displace jobs in direct ethanol production employment and even more than in indirect employment, including contract services, farming, transportation, mining and other related industries.
- Eliminate the economic incentive to establish a sugar-based ethanol industry in the Caribbean Basin. Dehydration only facilities return less than 10 cents per gallon to the local economy, while full fermentation facilities return multiple times that amount when the ripple effect of salaries, taxes, purchases, etc... are considered.
- Provide a dumping ground for an estimated 200 million gallons of heavily subsidized EEC wine alcohol to enter the U.S. duty-free via dehydration plants in the Caribbean. This EEC wine alcohol can be purchased for 40 cents per gallon, and transported and processed for 25 cents per gallon. The profit potential on 200 million gallons of EEC wine alcohol dehydrated in CBI countries is $80-100 million.

- Cost the U.S. Treasury up to $120 million in uncollected tariff revenues. (200 million gallons x $.60 the current ethanol tariff = $120 million). It is also important to note that all the imported ethanol is eligible to claim the partial federal gasoline excise tax exemption for ethanol blended fuels, which would amount to a loss of approximately $120 million to the Federal Highway Trust Fund.

Moreover, there will be little additional employment in the Caribbean as a result of these dehydration facilities. My husband operates our 1 million gallon per year dehydration facility by himself with time to spare. Transshipment doesn't strike me as a significant means of increasing employment. When we do full fermentation, six people are required to operate the business. Obviously, the larger the full fermentation facility, the more people it takes to operate it because of volume feedstock, bookkeeping, DDG and wastewater handling.

Again, because Minnesota is an open exemption state with an established ethanol market, it is likely that many of these devastating effects will impact Minnesota more severely than others. But even if CBI product did not directly enter Minnesota, the ripple effect of U.S. product displaced by CBI dehydrated ethanol in other markets would be attracted to Minnesota by our favorable tax treatment, driving ethanol prices down further and eliminating any profit margin for domestic producers.

A marketing reality that is so clear that even a fifth grader realizes its inevitibleness is that if you have 100 gallons of something and five of those gallons are being sold for less than all the rest, that those five gallons set the price. The conscequences are evident without further explanation.

Another reality that anyone who has started up a plant knows is that when a new plant is coming on line it is critical that the ethanol be moved out and sold rapidly. It is not possible to hold it in storage until a new market is opened up. You have to get the product into the market and sold so that you have cash flow coming back in. To start up a new market area, you have to have product volume that is established, predictable and reliable.

The fact is that Minnesota ethanol producers cannot compete with the privileged trading companies operating dehydration-only facilities under the CBI and taking advantage of the cheapest feedstock in the world - heavily subsidized wine alcohol from Europe. But more importantly, it was not the intent of the State of Minnesota, in aggressively pursuing its ethanol promotion and education program, to provide the European Community with a ready made market, complete with tax incentives, for wine alcohol that the EC can't dump on world markets.

The Benefits of An Indigenous Caribbean Ethanol Industry

Much like Minnesota, the Caribbean Basin has a chronic shortage of energy and imports almost all of its fuel. This would appear to be a contributing factor to the economic instability of the region. The Caribbean's economic problems are also related to the vacillation of the world sugar markets. In my opinion the world sugar problems have been caused greatly because of the dumping of EEC sugar. The problems caused by the dumping of EEC sugar is not likely to be fixed by the dumping of EEC alcohol. This is like trying to solve a problem by allowing the EEC to do even more of what they have been doing. As a result, many sugar cane fields have been taken out of production and jobs have been lost.

A full fermentation, indigenous ethanol industry using Caribbean sugar cane, Caribbean workers and marketed in the Caribbean to reduce the region's energy dependence can make a substantial improvement in the quality of life in the Caribbean Basin. It is only this kind of investment and development which makes sense for the CBI countries. However, it will require the level of commitment which we made ten years ago. And it will require more than the export-only program established by the duty free status of the CBI.

As the Committee deliberates this issue, I would hope that you will explore options other than merely modifying the domestic content requirements of current law to encourage the increased transshipment of foreign feedstocks. The Committee could explore options which would in fact encourage the development of an indigenous industry and satisfy the Congressional intent of building a more economically, politically and energy secure Caribbean Basin. We've done it in Minnesota. We're proud of it. It works.

My final thought I would like to pose to you in the form of a question. This whole debate and discussion is not so much a question of number of gallons, percent of feedstock, or how much longer to extend, but rather it is a policy issue. Is the signal that the U.S. Congress wants to send to potential investors in domestic facilities that Carribean countries are going to be treated the same as domestic facilities, or are they in reality going to be treated better? And that's a very strong signal. We question that it makes sense to treat them better. A vote to prolong the duty-free pass through of European wine is a vote to treat a few privileged Caribbean companies better than American producers, investors and farmers.

Chairman GIBBONS. How long do you expect this to be subsidized before you become viable?

Ms. GRAF. Oh, I think that part of what I go into here also explains it. Yes, I would like to see the subsidy—I don't like the word "subsidy"—I prefer to call it "incentive"—extended to about the year 2000, and I have reason for that and it is not for ADM that I want to see that occur. I want to have it occur because part of what——

Chairman GIBBONS. Well, will you be self-sufficient by the year 2000?

Ms. GRAF. Let's hope that we are.

If you can tell me what fuel is going to do, then probably I can answer that. But it's very difficult, I realize.

The primary thing I want to say is that I am simply 1 individual in the State of Minnesota. I happen to have the opportunity to wear these three hats. Because of that, I work with people from various project sizes who want to put up a total of 258 million gallons of new production here in the United States. They are dependent upon—the financiers are looking at, the people who are going to be the lenders on these facilities are looking at, of course, the business plan. And I must say that the business plans do not include a feedstock that is not assured, which is a curious concept. But that's not my concept to have to deal with. They are looking to business plans. They're looking at the extension of 6 cents.

It is very important to lenders because it will take 2 years for a facility to get up. These are real plans. These people have been working on these plans from anywhere, 1 to 4 years. And they are concrete.

Second, the United States does not have really a long-term energy policy, and that is a concern to the investors.

And the third area that mutually is talked about is the concern about the Caribbean Basin Initiative and how the duty-free entrance of this alcohol can come in and affect the market of these plants that want to go up here in the United States.

A perfect case in point, and I hope that you have the written testimony from them. It is North Carolina Ethanol, Ltd. They want to put a 60 million gallon plant up there. They will have a total investment of the entire project, including cogeneration of $210 million that they have been working on for an extended period of time. They are doing the market preparation. They want to create a North Carolina Ethanol Commission to prepare the market to do that homework, to get ready for the forthcoming product that will be coming out of there.

They're going to be employing 125 to 150 people at the plant itself. During the construction period, it will be 200 to 600 jobs that will be created. This is on the way on the drawing board its happening. The seed money has been put in. It is in action.

A concern of their financiers is about the product from the Caribbean possibly coming into that market which is young. When you start up any company, you've got to move product. That's a simple fact of life. You can't sit and store it until you can open a new marketplace and develop it yourself. You can't store it until you've got Maine all set up to receive your product. You've got to go where the market is.

Chairman GIBBONS. They make it out of corn.

Ms. GRAF. Yes, they are going to make it out of corn.

Chairman GIBBONS. And how much does the corn program that we now have cost the taxpayers.

Ms. GRAF. I can't comment on that.

Chairman GIBBONS. Well, about a couple of years ago, it was costing almost $35 billion.

Mr. WENTWORTH. Sir, I think that number was $26 billion. And this program reduces——

Chairman GIBBONS. It dropped down during the drought. It was up around 35. My farmers don't receive one single penny of subsidy.

Why should we have to subsidize you guys? You are no better than me. You're no better than my farmers are. Why do we have to subsidize you to grow corn so that you can subsidize it further and make it into ethanol.

It's got to be one of the stupidest things this country has ever done. We're subsidizing the growing of corn, we're subsidizing the growing so that we can produce ethanol. Where does this crazy thing end?

I don't know when will be the next time I have to vote on this program. As far as I am concerned, I'll never vote for it.

Mr. SNYDER. If I could offer a thought, Mr. Chairman.

The history of the farm program goes all the way back to the New Deal. There is no short answer for that one.

Chairman GIBBONS. Why should we consider subsidizing the growing of corn and then turning around and subsidizing the production of ethanol?

Mr. SNYDER. Well, the point I was going to make is the ethanol program reduces the cost to the Government of the agricultural subsidies. So, at least that element of that program—I didn't intend to commence a dissertation on the history of our farm program.

Chairman GIBBONS. Well, but it all ties in, you know.

We voted on these things.

Mr. MATSUI. I would just like to make an observation. And I know everybody is tired, but I was looking at Ms. Graf's statement, written statement, and it starts off by saying good morning. [Laughter.]

Ms. GRAF. Optimistic.

Mr. MATSUI. I guess everybody is pretty worn down now. I know I am. But I am impressed with the chairman here who would stand all this.

And I can appreciate all of your concerns. I think what is frustrating, as Ms. Graf mentioned, is that there is some hostility here. Some of our comments reflect that. I think we all apologize for that, as I think it's more frustration than it is any hostility.

You see we did the Israel-United States Trade Agreement, we did the Canadian-United States Agreement. We just came up with an omnibus trade bill last year. And I have to tell you that every industry in America was concerned about each piece of that legislation. They all wanted to be protected or whatever the case may be. It was very frustrating for us.

And I know the chairman, who was the chairman of the Trade Subcommittee, saw all that. The real frustration we face right now is the fact that your industry, which is subsidized, both in terms of your basic product, corn, and then secondly at the pump in the form of ethanol, now will come in at a time when only 3 percent of the market has been penetrated.

I mean when you talk to textile workers in the textile industry, you are talking to about 15, 20, 50 percent of the market. Here you're talking about 3 percent of the market. I find that totally incredible because there are some industries that are really hurting as a result of open markets in the United States. Here, you are not suffering at all. You are getting big Government subsidies two ways.

For you to come in at this time and talk about these little Caribbean countries that—I invite you to go visit them sometime—are not going to be able to compete against you; they are not going to get a hundred million gallons of European wine. I mean let's face it. They are going to maybe get 3, 4, 5 percent of the market at the most, and you hope it will expand out. If you see any expansion of your industry, you are not going to be hurt by others. If you are, come back, because we not going to let domestic industry be hurt.

But the fact of the matter is you are not being hurt now, and I think frankly you are really overreacting. And that's what sad about this entire episode; the fact that there has really been an overreaction out there.

I know a lot of industries in California, Florida, and elsewhere that are really hurting. That's my problem.

Ms. GRAF. I would like to take the opportunity to make a final statement on that.

North Carolina Ethanol, Ltd., taking them as an example, if they could backward integrate, they would have their funding in place. Any of these facilities I'm talking about, with 100 million gallons, could be up tomorrow, if they could backward integrate also. It's a very unique thing.

And my question to you, when you consider there are investors prepared to invest here in this industry, there're constituents out in the country to prepare to do it. This is really a policy question.

Mr. MATSUI. Well, if we went back to January of 1988, I would say OK, I am willing to keep my mind open. But we have ITC studies, GAO studies, in fact, we've got these studies just because you raised these kinds of issues. Now, yes, that's a frustration, and frankly they're saying that there's been no impact, and the likelihood of having an impact is not there because they just can't get that European wine.

You know, the whole issue of competition is really—I don't know who you've been talking to, and I don't know where you've been getting your information. But I just don't see that there. And that's why this whole issue, as I mentioned it, is just really——

Ms. GRAF. I still would like to say I think it's a policy question. Is the signal of the U.S. Congress going to be to the people who want to invest in facilities here that you are going to treat them the same as the U.S. producers in the Caribbean or are they going to be treated better?

Mr. MATSUI. Well, I guess we're getting into a situation here and I won't comment on it.

Ms. GRAF. And that will impact the decisions made.

Chairman GIBBONS. You talk about all the investments being made, but are they going to invest if we don't extend the subsidy? You tell them you don't want to take their money under false pretenses. Don't think it's going to be this way forever, because international negotiations are going to get rid of all agriculture subsidies. The American farmer should be willing to get rid of all of them.

Ms. GRAF. I think that would be very unfortunate.

Chairman GIBBONS. They make no sense at all. They make no sense at all.

Mr. WENTWORTH. Sir, we agree with that statement that we are behind elimination of all trade distorting subsidies around the world. But it seems incongruous to us the main offender in the trade subsidy situation is EC. In allowing this program to continue, you are putting money in their pockets. You're bailing out their program.

Mr. MATSUI. Mr. Wentworth, why don't you file a 201 action? That's available under our trade law, Countervailing Duty Act.

I mean I don't know why you don't do that. And then let our current laws take care of your problem. If you're upheld, you're going to win. If it's a real subsidy that is harming your industry, you ought to file a 201 action. That is what I would tell my industries in California that are affected by this. That's why we passed that bill last year.

Mr. WENTWORTH. Well, we've seen some problems——

Mr. MATSUI. I don't think you can really win because, frankly, I don't think you can make a case. And the ITC and the GAO are saying that. I think you're spitting in the wind.

Ms. GRAF. I would really just like to reemphasize the signal you give out with your decision is going to be heard by those who want to invest here. Perhaps the case is just simply lower the cap; therefore, we don't need to worry that too much is going to come in to the point where it's going to be a threat, if that's the case.

Lower the amount so then we don't have to worry about it, and everything is done.

Chairman GIBBONS. All right. This concludes the hearing.

The record will be open until May 1 for other statements if people want to make them.

I thank all the witnesses for appearing today.

[Whereupon, at 5:50 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

DEPUTY UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON, D.C. 20506
202-395-5114

April 25, 1989

The Honorable Sam M. Gibbons
Chairman
Subcommittee on Trade
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

The Administration has not yet completed its review of all the factors influencing the production of ethyl alcohol (ethanol) in the Caribbean Basin and the United States. Nevertheless, we wished to inform the Subcommittee of the major factors we are taking into account in our discussions concerning the rule of origin for U.S. imports of ethanol from the beneficiaries of the Caribbean Basin Initiative (CBI).

At the end of this year, the rule of origin permitting any imports of ethanol to enter the U.S. market duty-free as an "indigenous product" of the Caribbean Basin will specify that 75 percent of the value of the product must result from feedstock produced within the region. The information compiled by the General Accounting Office (GAO) and the U.S. International Trade Commission (USITC) demonstrated the virtual impossibility of ethanol producers in the Caribbean Basin remaining competitive in the U.S. market, under current conditions, if they are forced to meet the 75 percent local feedstock requirement presently mandated by the 1986 Tax Reform Act.

We must recognize that application of this high local feedstock requirement in 1990 could end virtually all shipments of ethanol from the Caribbean Basin for the foreseeable future, which would result in a certain amount of economic dislocation in Costa Rica and Jamaica. It would also raise the cost of ethanol to U.S. consumers. In addition, such an action could mean that two facilities currently under construction in the region probably would never be completed.

While the survival of a competitive ethanol industry in the Caribbean Basin is likely to depend on the rule of origin, we recognize that the choice of a rule of origin for imported ethanol from the Caribbean Basin is a very complex policy question, requiring the careful weighing of a number of factors.

On the one hand, we must take into account the interests of U.S. corn growers, domestic ethanol producers, and the budget and economic costs to the United States of the programs assisting them. On the other, we must consider the commitment made by the United States to the economic growth and development of the Caribbean Basin through trade and investment, as embodied in the Caribbean Basin Initiative (CBI).

Still another consideration is the role played in CBI ethanol production by imports into the region of low-cost European wet alcohol for use as a feedstock for dehydration operations. The existence of this subsidized feedstock, and its possible market effects on world ethanol production, are directly linked to broader U.S. negotiating objectives within the Uruguay Round designed to bring world agricultural trade under GATT disciplines and to achieve "substantial progressive reductions in agricultural support and protection."

The Omnibus Trade and Competitiveness Act of 1988, in section 1910, offered the opportunity to shed new light on the interrelationships among these various factors. We believe that the GAO and the USITC did a fine job in clearly presenting information describing the current state of the industry in the Caribbean Basin and in the United States.

Their reports also noted the difficulty of determining a new formula on which to base a rule of origin, in view of the number of factors influencing market conditions, that would allow Caribbean Basin producers to remain competitive in the U.S. market. Because of the large number of variables influencing the competitive effects of any given level of percentage of local feedstock content, neither report made a specific recommendation. The GAO and USITC also noted, however, that a variable local feedstock percentage that would change with market conditions would be difficult to administer and would lead to continued uncertainty for Caribbean Basin ethanol producers.

Under current legislation, five producers in the region (three of whom are in actual production) are exempt from the 75 percent local feedstock requirement until the end of 1989. The hearing which the Trade Subcommittee is holding on April 25 should help to clarify the various factors that must be taken into account in reviewing the rule of origin question for ethanol produced in CBI beneficiary countries.

We agree with the GAO's conclusion that the three policy objectives contained in section 1910 of the Omnibus Trade Act -- that a local feedstock requirement should: (1) increase meaningful production and employment in the region; (2) discourage pass-through operations; and (3) result in no harm to

U.S. ethanol producers -- are to some extent in conflict with one another and, therefore, necessarily involve certain trade-offs.

Ethanol economics in the United States and the Caribbean Basin are a function of many variables, a number of which are subject to frequent fluctuations. Among the more relevant factors are: world oil prices, U.S. and world sugar prices (and the future of the U.S. sugar import program), U.S. corn prices, European wine prices and excess supply, U.S. gasoline supply and demand, and environmental requirements in certain areas of the United States which are seeking to attain U.S. air quality standards.

The Administration reached the following major conclusions in reviewing the rule of origin question for Caribbean Basin ethanol:

- We agreed with the principle that new ethanol production in the Caribbean Basin should be expected to incorporate a significant level of CBI feedstock content.

- We would like to see a resolution to the rule of origin question for U.S. duty-free imports of Caribbean Basin ethanol which would allow investors and Caribbean Basin sugar producers to plan a future direction for the region's ethanol industry.

- We further agreed that operations in the Caribbean Basin relying heavily on the mere dehydration of European wet alcohol are not in the long-term interests of either the CBI beneficiary countries or the United States.

The resolution chosen for a rule of origin applying to CBI ethanol, in our view, should balance the legitimate interests on both sides of the question.

I appreciate this opportunity to offer the Administration's comments on a rule of origin for duty-free U.S. imports of ethanol from the Caribbean Basin. We will listen carefully to the comments expressed about ethanol imports from the CBI during your hearing on this issue. I am sure that we will find those views informative as we continue to define our own position on the CBI ethanol rule of origin question.

The Honorable Sam M. Gibbons
Page Four

The Office of Management and Budget advises that there is no objection to the presentation of this report from the standpoint of the Administration's program.

Sincerely,

Joshua B. Bolten
Acting

JBB:csa

[BY PERMISSION OF THE CHAIRMAN:]

April 19, 1989

ALLIED ETHANOL, LTD.
GRAND BAHAMAS ISLAND
GRAND BAHAMAS
Burton M. Joseph, President

STATEMENT FOR THE TRADE SUB-COMMITTEE OF THE WAYS AND MEANS COMMITTEE OF THE HOUSE OF REPRESENTATIVES CONCERNING THE DECISION TO EXTEND GRANDFATHERING FOR THE CARIBBEAN BASIN INITIATIVE ETHANOL PROGRAMS.

A. HISTORY

In 1985, Allied Ethanol, Ltd., relying on the promises and persuasion of the United States Government and using the appropriate guidelines of the Caribbean Basin Economic Recovery Act, decided to construct a factory to produce anhydrous ethanol in a CBI beneficiary country. The raw material to be used would be a combination of raw stock alcohol produced in the host country or other friendly countries and other bio-mass raw material to be upgraded by a substantial chemical and physical transformation into the finished product; high quality, fuel grade ethanol. This fuel grade ethanol would be exported from the Caribbean Basin country to the United States duty free for marketing and blending into gasoline at the approved Customs Service ratio of 10% ethanol with 90% gasoline.

Allied Ethanol and four other companies, performing a similar function in the Caribbean Basin, relied upon United States law and Treasury Department (Customs Service) ruling that Allied's process technology fulfilled the requirement of "substantial transformation". Customs Service also recognized that Allied created a "new and different article of commerce" in accordance with the Customs Service requirement.

As a result of the above guarantees made in good faith by the United States Government and accepted in the same spirit by Allied Ethanol, Allied proceeded to locate a site - Grand Bahamas Island - in the Grand Bahamas Group - and to begin construction.

In 1986, in a shocking turnaround prompted by the lobby of the United States domestic ethanol industry, the Congress of the United States in the 1986 Tax Bill changed the law that Allied had relied upon. The duty free entry privilege for fuel grade ethanol, which is the basis for Allied's investment in the Caribbean Basin, was removed for CBI ethanol processed under Customs Service rules. Allied was left with a very short transitional rule for 1987 and 1988 for half the rated capacity of Allied's plant. This rule was later extended for one year to the end of 1989 but the investment damage had been done. Allied's investors who had already provided seven million dollars to the project were no longer willing to commit further with such a limited and uncertain timetable parameter. It is simply not reasonable to ask investors to go forward with a program sponsored by the United States Government unless that same Government deals fairly with the investor by providing an appropriate timetable for the investment to earn out.

This is the current position of Allied Ethanol; we acted in good faith and had that faith violated by the Congress of the United States. Our project is now in limbo awaiting the renewed expression and action of good faith on the part of our Government.

B. WHAT IS NEEDED

The Office of Management and Budget, when directed by the Congress to study and judge this matter, has concluded that Caribbean Basin production offers no threat to the domestic producers. The study stated that one option for the entire industry, both Caribbean Basin and domestic, would be for the CBI to provide 20 million gallons per operating factory with no feedstock requirement. This would limit the Caribbean Basin to less than 15% of the total production of the ethanol used in the United States.

Given the recent developments in energy and weather, there are many reasons why this modest 15% should be welcomed by the American energy industry and the American consumer.

First, energy prices are again soaring. We have the same dangerous combination of forces at work; a build-up in the foreign requirement for crude petroleum in the United States from 25% to 45% making the United States again vulnerable to the political and economic disruptions as experienced in the 1970's.

Second, the weather patterns in the farm belt of the United States are ominous. The drought of 1988 is now showing a repeat pattern for 1989. The United States needs ethanol supplies other than that from the domestic corn crop. It is likely that corn supplies will be dearly priced for domestic ethanol production. The Caribbean Basin supplies are an important and necessary part of the ethanol industry.

Third, the Caribbean Basin needs the economic support provided by the ethanol industry. It is ironic that with the huge subsidy provided for the domestic ethanol industry and the relatively small supplies from the CBI ethanol group that the modest, legislatively limited endeavor of poor allied countries should prompt cries of unfair play by the lobbyists of the domestic industry.

Fourth, a new product is now under development by the energy industry of the United States called ETBE which will include ethanol as a constituent. ETBE is a further and advanced substitute for lead in gasoline and will provide the octane requirements for gasoline formerly supplied by lead. ETBE will require much more ethanol.

Finally, the domestic industry is now thriving. Its principal supplier, Archer Daniels Midlands, shows higher earnings each year, now reaching record levels. We know that CBI ethanol supplies can actually compliment the middle west grain ethanol industry. The overwhelming majority of fuel ethanol sales occur

in the middle west where nearly all the production is located. There is little doubt that Caribbean ethanol is needed in the coastal states. The absence of ethanol supplies in certain parts of the country leads to wide distortion in availability and prices. Consequently, the CBI ethanol will preserve and supply the vast coastal markets for ethanol production. The CBI producers will in effect protect the coastal states for new ethanol product as the market grows and until the new domestic capacity becomes available.

We urge the Trade Sub-Committee of the House Ways and Means Committee to right the record to make good on the original promise and hope for the Caribbean Basin countries. The CBI needs to produce a given amount of ethanol for the American market.

The Caribbean Basin Initiative ethanol companies need a transition rule through 1995 to protect and enter into the United States, a fair quantity of duty free, fuel grade, ethanol in the volume recommended by the Office of Management and Budget. This keeps with the sense of fair play and equity promised by the United States Government.

ATTACHMENT: Article from the FINANCIAL TIMES, London, reviewing damage to Caribbean Basin ethanol industry.

Financial Times Thursday June 30 1983

ND AGRICULTURE

Canute James reports on the plight of the Caribbean ethanol industry

US demands force plant closures

THE CARIBBEAN ethanol industry, once regarded as an alternative outlet for the region's troubled cane sugar producers, is on the verge of collapse. Amid claims of increasing protectionism in the US, the main market for the region's ethanol, producers are shutting up shop.

In the face of increasing difficulty in gaining preferential access to the US market, Lica, a producer in Costa Rica owned by private and public interests, has closed down: a 40m gallons-per-year plant in Jamaica, owned by a subsidiary of the island's state-owned oil company, has been idle since January; and Tropicana Jamaica, a subsidiary of Tropicana Petroleum of California, which runs a 30m gallons-per-year plant, says it will have to close by the end of the year.

Behind the problems which have overtaken an industry which was regarded five years ago as part of the Caribbean's solution to the declining viability of its cane sugar production, are changes imposed by the US government, which has demanded that higher levels of locally-grown feedstock be used in the region's ethanol production before the product can enjoy duty free entry.

But Caribbean governments and companies complain that the conditions are impossible to meet, and that meanwhile domestic US ethanol producers are being given significant subsidies to increase production.

US demand is estimated at just under the gallonsper year, most of which is used as a fuel additive to increase octane ratings.

Caribbean producers, who have been using cane sugar as the major feedstock for their plants, say existing and potential investments of about 210m are threatened by the US stance. New plants have been planned in the Bahamas, El Salvador and the Dominican Republic.

The decision by several countries to encourage investment in ethanol was stimulated by the Caribbean Basin Initiative, a 12-year trade programme implemented by the Reagan administration in January 1984, allowing countries designated by Washington to ship a range of products duty free to the US.

Ethanol, along with all but a handful of so-called sensitive products, was granted preferential entry as long as 35 per cent of the value added accrued to CBI beneficiary states. The producers met this criterion easily, using canewhich were not needed for sugar production.

But efforts to provide markets for maize producers in the US Midwest were followed by representations to legislators in Washington, resulting in more difficult terms for Caribbean ethanol destined for the US market.

The 35 per cent regional added value criterion was raised to 60 per cent, and is to move to 75 per cent in January. Regional producers have been lobbying intensely in Washington, but so far without much success, to have the figure reduced by January. "If nothing happens by then we too will have to shut down," said Mr William Maloney, the chief executive of Tropicana Jamaica.

Caribbean government officials, who say the issue is being raised with the Reagan administration, argue that the region's new industry is paying the price of openly political efforts to keep the US ethanol industry alive. They claim that US domestic production of 900m gallons last year was possible only because of generous state and federal tax incentives. Left to fend for itself, they claim, the US ethanol industry would collapse.

While not denying that this very fate threatens the Caribbean industry if it does not have the crutch of easy preferential access to the US, producers say they need better breaks, in the form of reduced regional added value criteria, if they are to eventually stand on their own feet.

The region's producers have been accused in the past by lobbyists for the US industry of using feedstock from Spain and Brazil, not carrying out any substantial transformation, and consequently using the duty free facility for effectively dumping European and South American ethanol on the US market.

But the region's producers say there is not enough raw material in the Caribbean significantly to increase the use of feedstock to meet the new value-added criterion and to run plants at full capacity.

Of Tropicana's current output of 28m gallons per year, Mr Maloney says, feedstock available in the region can produce only 5m gallons annually. The company recently leased a 2,000-acre sugar cane farm and mill in Jamaica as part of its effort to increase local feedstock.

Petronol, the Jamaican state-owned producer, has leased the Libertad sugar estate and mill in Belize from Belize Sugar Industries. The mill is to be used for the production of alcohol which will be shipped to Jamaica for conversion to ethanol.

"It is indeed very unfortunate that after investors here have put money into an industry which was offered some protection before it could stand on its own, the US has destroyed all hope of a viable venture," complained one Costa Rican official.

The producers, however, are not abandoning the industry, and are hoping that government and private representations in Washington will bring more favourable terms for access to the US market. "We are looking for alternative markets and lobbying strongly in Washington," said Mr William Saunders, managing director of the Petroleum Corporation of Jamaica, which owns Petronol.

Inevitably the new barriers for the regional ethanol industry have resulted in some bitterness. Mr Maloney says: "It seems a clear breach of faith with the region and the emphasis of the Caribbean Basin Initiative. Either the administration did not believe or support the CBI in the first place . . . or it is out of touch with the reality of the situation."

Statement of

Caribbean/Central American Action

to the

Subcommittee on Trade
of the
Committee on Ways and Means
U.S. House of Representatives

Hearings on the issue of

Fuel ethanol imports from the Caribbean Initiative countries

April 25, 1989

Caribbean/Central American Action
1211 Connecticut Avenue N.W., Suite 510
Washington D.C. 20036
(202) 466-7464

STATEMENT OF

PETER JOHNSON
EXECUTIVE DIRECTOR

CARIBBEAN/CENTRAL AMERICAN ACTION

Caribbean/Central American Action is an organization dedicated to the promotion of economic development through private-sector growth in the Caribbean Basin. Our organization has sought since its foundation in 1979, to encourage the growth and expansion of business activity in order to increase economic opportunities and generate employment. It is because of this mandate that we have had an on-going interest in the issue of ethanol exports from the Caribbean Basin countries.

In 1983, Congress enacted the Caribbean Basin Economic Recovery Act or the CBI. Under this Act, eligible products from the Caribbean and Central America are permitted duty-free entry into the U.S if 35 percent of the value of the product is added in a CBI country and it is "substantially transformed." Encouraged by this legislation, several companies--both U.S. and local--established facilities for the production and export of fuel ethanol. In 1986, Congress enacted legislation which changed these requirements for fuel ethanol imports. Under the new law, ethanol exports to the U.S. could receive duty-free treatment only if local feedstock accounted for 30 percent of the value of the ethanol in 1987. This percentage increased to 60 percent and 75 percent in 1988 and 1989 respectively. The 1988 requirement created hardship for the CBI companies and in an effort to resolve this, Congress instructed the General Accounting Office (GAO) and the U.S. International Trade Commission (ITC) to examine the local feedstock requirement and assess whether the requirement was economically feasible and, if not, to recommend modifications to the requirement.

The plants originally established in the region are located in Costa Rica and Jamaica. In Costa Rica, these facilities are owned by the Liga Agricola Industrial de la Cana de Azucar (LAICA), a cooperative association of all the sugar growers, workers and distillers in that country. In Jamaica, the two facilities are owned by Tropicana, a U.S-based company, and PETROJAM, a state corporation owned by the Jamaican government. Both of the Jamaican facilities lease or own sugar mills which provide some of their feedstock requirements. In addition, PETROJAM also owns a mill in Belize. By restoring these mills to production, these companies have played an crucial role in preserving jobs in the sugar industry (in both Belize and Jamaica) that would otherwise be lost and in creating new jobs.

In these times of reductions in the U.S. sugar quotas available to the Caribbean Basin, these production facilities offer needed alternatives to the traditional production and export of sugar and provide employment stability in an industry which is in crisis. In addition, fuel ethanol exports are a source of foreign exchange and government revenues in these countries. However, because of the lack of resolution in this issue, the ethanol industry's potential contributions to the Jamaican and Costa Rican economies has not been realized. The uncertainty that has existed in the industry in the last two years has shut down production, threatened jobs and made any meaningful business planning nearly impossible.

We believe that the GAO and the ITC have been successful in achieving the objectives set by Congress in 1988 and would like to commend them on the excellent analysis of the issues affecting CBI ethanol exports. We would like to urge Congress to identify a permanent solution to this issue as soon as possible within the recommendations of these reports which are based on objective analysis and study. A speedy solution to this problem will return the companies to production and the workers to their jobs.

CENEX COMMENTS ON FUEL ETHANOL IMPORTS FROM CARIBBEAN BASIN INITIATIVE COUNTRIES

APRIL 28, 1989

Description of Cenex

Cenex is a cooperative corporation organized and operating under Minnesota Statutes, Chapter 308, as amended, and is treated as a cooperative under Sec. 1381 of the Internal Revenue Code, as amended.

As a major regional cooperative, Cenex serves--and is owned by--approximately 1,600 independently owned cooperatives which, in turn, serve about 500,000 farm families located in 14 northwestern states.

The Cenex Petroleum Division performs all the functions of an integrated, independent oil company, in that it develops oil and gas prospects, secures leases, drills wells, produces oil and gas, and refines, transports and markets petroleum products, including ethanol-enhanced gasoline.

Cenex owns and operates its own petroleum refinery in Laurel, Montana (capacity: 42,500 barrels per day) and also operates its own 425-mile pipeline connecting the Laurel refinery with Cenex terminals in Glendive, Montana, and Minot, North Dakota. Cenex owns and operates three other terminals, located in Chippewa Falls, Wisconsin; McFarland, Wisconsin; and Vancouver, Washington; and has a one-third interest in the Green Bay Terminal Corporation, Green Bay, Wisconsin.

Cenex is also in the ethanol production business, having acquired, in November 1987, an 11-million-gallon-per-year ethanol plant in Walhalla, North Dakota. In the interim we have modernized the plant and increased its efficiency. Planning is now in progress to implement, at some future date, a capacity expansion to about 28 million gallons per year.

National Commitment to Ethanol

For over ten years, the U.S. Congress has demonstrated a solid commitment to the development of a viable domestic ethanol industry. As a means to reaching this goal, Congress in 1978 passed, and the President signed, legislation exempting 10 percent ethanol-blended gasoline from the four-cent federal excise tax on gasoline. When the tax was increased to nine cents, ethanol-blended gasoline was given a six-cent exemption. This tax differential was adopted with a view to making ethanol blends fully competitive in the marketplace vis-a-vis ethanol-free gasoline.

In addition to the partial excise tax exemption, Washington during the past decade has enacted a number of other incentives to encourage domestic ethanol production. These include a blenders tax credit, research and development grants, guaranteed loans, and a protective tariff.

Thanks to this commitment to ethanol on the part of government (both federal and state), over 1.2 billion gallons per year of ethanol productive capacity has gone on stream in the UnitedStates. In 1988, more than 850 million gallons of fuel ethanol were produced by 55 plants located in 23 states.

As a result of this impressive ten-year development, America is less dependent on overseas oil; farmers have an additional market opportunity for their corn and other grains; agricultural communities have been revitalized with the creation of thousands of jobs across the farm belt; and our air is safer to breathe.

Ethanol Pays for Itself in Reduced Farm Program Costs

In the last two or three years, numerous studies and cost-benefit analyses commissioned by the White House and by the Congress have strongly endorsed government efforts to promote ethanol--on both national security and environmental grounds. These reports have pointed out, moreover, that the costs of federal incentives to ethanol producers and blenders are more than offset by lower federal farm program costs.

The Renewable Fuels Association (RFA), Washington, D.C., estimates that the production of ethanol each year utilizes nearly 360 million bushels of corn in the United States, adding $1 billion to farm income while reducing federal farm program costs by $700 million.

U.S. Decision to Foster Caribbean Economic Development

The Caribbean Basin Economic Recovery Act of 1983 went into effect on January 1, 1984. The act, commonly referred to as the Caribbean Basin Initiative (CBI), provided for designation by the President of 22 countries and territories around the Caribbean as eligible for duty-free treatment of articles exported to the United States. Congress' purpose, in drafting the legislation, was to promote economic revitalization and expand economic opportunity in the Caribbean region through unilateral U.S. trade concessions.

Under the 1983 Act, duty-free entry into the United States is not extended to all goods produced in the CBI countries. Major exceptions include textiles and apparel, footwear, watch parts, and petroleum products. The exclusion of petroleum products was considered necessary to avoid any interference with U.S. oil import policy. More specifically, the petroleum exclusion was adopted to ensure that the CBI did not become a tariff loophole to the detriment of the domestic refining industry. As the Ways and Means Committee later put it, the petroleum exclusion "would also eliminate the potential problem of transshipment of worldwide oil imports through CBI countries as a means of avoiding the duties."

Tariff Loophole for Surplus Alcohol from Europe

As a result of an early ruling by U.S. Customs, the CBI duty exemption became available to ethanol which had undergone a simple dehydration process in one of the CBI countries, without regard to the source of the feedstock. As a result of this ruling, a Caribbean ethanol "industry" quickly developed to take advantage of (1) the need of European governments, such as France, Italy and Spain, to dispose of huge quantities of surplus wine alcohol, (2) the growing demand for fuel-grade ethanol in the United States, and (3) the U.S. tariff loophole under the CBI. Clever investors were quick to position themselves to make large profits with minimal expenditure of capital.

Processors Exempted from Local Content Rule

In 1986 Congress sought to close the tariff loophole, or at least to limit its applicability. The Tax Reform Act of that year provided that ethanol from CBI countries could enter the United States duty-free only if feedstock from the region accounted for at least 75 percent of the value of the ethanol by 1989. In addition, Congress was prevailed upon to "grandfather" certain facilities which were already in operation or under development, by exempting them from any immediate local content requirement.

Last year's Omnibus Trade Bill (H.R.3), which was vetoed by President Reagan, contained a provision extending the 1986 grandfather clause by granting five of the ethanol processing facilities already operating in the Caribbean an additional 18 months of duty-free status before they graduated to a higher local content requirement. The veto message mentioned "expanded ethanol imports" as one of the objectionable features of the bill. Nevertheless, the "clean" trade bill, which was subsequently enacted, contained the same 18-month extension.

Local Content Rule Subject to Further Study

Clearly, the Congressional intent in passing the 1988 trade bill was to keep the basic ground rules in place until the controversy over local content could be resolved through further study. Section 1910 of the bill provided as follows:

> "The United States International Trade Commission [ITC] and the Comptroller General of the United States [GAO] shall each immediately undertake a study regarding whether the definition of indigenous ethyl alcohol or mixtures thereof used in applying [the duty-free provisions] of the Tax Reform Act of 1986 is consistent with, and will contribute to the achievement of, the stated policy of Congress to encourage the economic development of the [CBI countries and U.S. insular possessions] through the maximum utilization of the natural resources of those countries and possessions."

The two agencies were required to report their findings to the House Ways and Means Committee and the Senate Finance Committee before the 180th day after enactment. These reports were submitted in February of this year.

Both Reports to Congress Based on Faulty Premises

A key conclusion reached in the GAO report was that "eliminating any [indigenous feedstock] requirement would give CBI ethanol producers an advantage in the market if the CBI companies can readily obtain subsidized European wine alcohol supplies at low prices." However, the GAO **failed to conclude whether giving the CBI "producers" such a market advantage over U.S. ethanol producers would be good or bad in terms of the U.S. national interest.** The options it suggested indicate that the GAO believed Congress was interested only in protecting the market position of the CBI "producers."

The ITC report, in a similar vein, included the following statement:

> "Imported feedstocks, principally from the European Community in the form of wine-based, partially distilled hydrous ethanol, have enhanced the competitiveness of Caribbean Basin producers by lowering overall feedstock costs. . . The primary feedstock used by the Caribbean ethanol industry to produce the nonindigenous portion of their fuel ethanol for export to the United States has been surplus European wine alcohol, the European 'wine lake'."

Both reports missed the main point by apparently basing their analyses on the following premises: (1) that ethanol dehydration is equivalent to ethanol production, (2) that such processing is consistent with the intent of Congress to stimulate economic development and employment in the region through the maximum utilization of indigenous resources such as locally-grown sugar cane, and (3) that Congress must determine a level of imported hydrous (wet) alcohol at which the five CBI ethanol processors can operate and still be profitable in the U.S. motor fuels market. Cenex believes that, because of these erroneous premises, neither report can be used as a basis for making policy in an area that is so critical to the survival of the domestic ethanol industry.

Dehydration Not Same as Production

There is a profound difference between producing ethanol from sugar cane feedstocks indigenous to the CBI and the simple processing of ethanol from 190-proof "wet" European wine alcohol. To produce 195-proof fuel-grade ethanol, one not only needs access to agricultural feedstocks, one must also have the ability to ferment sugars into alcohol. It requires substantial capital investment and is highly labor-intensive.

On the other hand, to dry out wet alcohol, all one needs is an inexpensive, simple dehydration tower. One such process involves nothing more than adding benzene to the wet alcohol and heating it to the point at which the benzene vaporizes, carrying with it most or all of the remaining water. A dehydration tower is normally an integral part of an ethanol production facility. Absent the CBI tariff loophole, it makes no economic sense to maintain separate fermentation and dehydration facilities.

The economic impact of the processing facilities, which were installed by outside financial interests to take advantage of the CBI tariff loophole, is negligible. They employ few workers and utilize no locally-produced feedstock. The RFA estimates that a dehydration-only facility, using non-Caribbean feedstocks, returns only 10 cents per gallon of ethanol to the local economy. A full-fermentation plant using indigenous feedstocks, on the other hand, would return about $1.50 per gallon to the local economy under current market conditions. In terms of job creation, a dehydration-only facility creates only four jobs per million gallons of capacity, while a full-fermentation plant, based on Caribbean sugar cane, could be expected to create about 410 jobs per million gallons.

Surely, it is the latter scenario which Congress had in mind in 1983 when it created the Caribbean Basin Initiative. In fact, Congress explicitly designed the CBI to prevent "pass-through" operations of little economic benefit to the host countries that are in need of economic assistance.

We are Frustrating our Own Goals in the CBI

By permitting the continued existence of simple dehydration facilities in the Caribbean, Cenex maintains that Congress not only is failing to promote economic development in the Caribbean, it is actually harming the economies of the CBI countries by eliminating any economic incentive to establish an ethanol industry based upon home-grown sugar cane. As long as they have access to the virtually limitless, heavily subsidized supplies of European wine alcohol, the processors who have been grandfathered will continue to try to maximize alcohol imports at the expense of local agricultural development. Thus, the stated goals of the CBI continue to be frustrated by our own ground rules and interpretations.

Current Investigation Too Narrowly Drawn

When the April 25 hearings were announced on April 13, 1989, the Subcommittee stated that Congress' purpose last year in calling for reports from the ITC and the GAO was--

> ". . . to study whether the 75-percent local feedstock requirement will contribute to the economic development of the CBI countries, and whether the requirement is economically feasible for ethanol producers."

The Subcommittee's announcement went on to state that the April 25 hearing--

> ". . . will focus on the impact of existing requirements governing imports of fuel ethanol from CBI countries, and consider the proposals for change contained in the GAO and ITC reports."

Cenex maintains that this view of the purpose of the GAO and ITC reports, and consequently the focus of the Subcommittee's current investigation, are too narrowly drawn. The Omnibus Trade Bill, as it was finally enacted, stated that if the ITC and the GAO reached the conclusion that the "indigenous product percentage requirements" of the 1986 Tax Reform Act are not "economically feasible" for the ethanol "producers" who were grandfathered by that act, they should recommend changes in the percentage requirements that--

> "(i) will ensure meaningful production and employment in the region,
>
> "(ii) will discourage pass-through operations, and
>
> "(iii) will not result in harm to producers of ethyl alcohol, or mixtures thereof, in the United States".

Finally, the two agencies were required by the Act to include in their reports, "an assessment of the effects of imports of ethyl alcohol, and mixtures thereof, [from CBI countries] on producers . . . in the United States."

It is this clearly expressed Congressional concern about the effects of ethanol productions on the economies of the CBI countries, as well as the effects of ethanol imports from that region on the domestic ethanol industry in this country, that seems somehow to have been lost in the shuffle. There is

consequently a danger the Subcommittee will not give sufficient attention to these two key issues as it weighs the ITC and GAO recommendations and the views of the Administration and the private sector it has received subsequently.

It should not be the purpose of this inquiry to debate the question whether a 75 percent ad valorem local content rule should apply, or whether the percentage should be some other figure. We believe that any local content requirement below 100 percent is unjustified, in terms of local development as well as in terms of fair play for American producers who rely for their primary feedstock upon American agriculture. Any formula which tends to postpone Caribbean economic development, or to jeopardize the orderly growth of the U.S. ethanol industry, therefore, must be avoided.

We Support Economic Development, Reject Pass-Through Operations

Cenex wholeheartedly supports U.S. efforts to foster--through the CBI and through multilateral economic assistance programs--the agricultural, industrial and commercial development of the Caribbean region, provided it is based primarily upon indigenous raw material, resources and/or labor. We are categorically opposed, however, to any legislation which permits the continued dumping in the U.S. market of significant quantities of subsidized European wine alcohol by way of the Caribbean.

It has been amply demonstrated, by the Renewable Fuels Association as well as by others, that the current situation is inflicting serious harm on the domestic ethanol industry. The market for ethanol in this country is not yet large enough to accommodate both domestic producers and Caribbean-based processors of surplus alcohol from France, Italy and Spain. Last October, in its comments to the ITC, the Association pointed out that--

> ". . . the saturation of profitable markets has already contributed to the domestic industry operating at only 80% of total nameplate capacity as many small producers have idled plants because of the unavailability of profitable markets. Thus, the displacement caused by CBI dehydrated ethanol would result in additional U.S. productive capacity being idled."

Domestic Producers Need Reasonable Profit Margins to Survive

Most U.S. ethanol producers, moreover, operate on fairly narrow profit margins in the best of times, despite the various tax incentives provided by state and federal governments. We can attest to this, certainly, from our own brief experience in the ethanol business. The Cenex ethanol plant in Walhalla, North Dakota, for example, has been shut down since last summer when poor harvests led to sharp feedstock price increases at a time of depressed world oil prices. In the interim, we have modernized the plant and are planning to reopen it this summer.

Just as our Walhalla operation can be disrupted by increases in raw materials costs, we could be forced to close the plant indefinitely if the price of the finished product were to be substantially depressed as a result of failure by the Congress to close the CBI tariff loophole. There is no way we will remain in the business of producing ethanol, unless we can do so with the prospect of reasonable profit margins. We believe we are hardly alone in this attitude.

Concluding Comments

As it wrestles with the CBI local content issue over the next few weeks; Cenex hopes the Subcommittee will not lose sight of the following basic principles and goals:

- The Caribbean Basin Initiative was enacted in order to strengthen the economies of the beneficiary countries and expand economic opportunities for the peoples of those countries.

- It makes no sense for the United States to provide unilateral trade concessions, supposedly for the benefit of a certain region, if we then turn around andfail to prescribe strict local or regional content requirements in order for goods to qualify for such concessions.

- The 75 percent local content rule presribed in the basic CBI statute should be seen as only a starting point for working toward a requirement that, before fuel-grade ethanol or any other fungible goods qualify for duty-free treatment, their primary feedstock should be essentially home-grown.

- Simple pass-through facilities, such as have been installed in CBI countries by outside financial interests merely to take advantage of U.S. tariff concessions, do nothing to revitalize the economy of the host country.

- In fact, extension of duty-free privileges by the U.S. to certain ethanol processors in the region actually hurts the economies of the host countries by eliminating any economic incentive to establish an ethanol production capability based on indigenous raw materials.

- Some ethanol dehydrators who have been grandfathered under the CBI legislation have profited from U.S. tax loopholes; there is no economic justification whatsoever for further extensions of their privileges.

- A viable and growing domestic ethanol industry, which utilizes American-grown feedstocks, is very much in the national interest; moreover, it represents a sizable investment by the private sector and the nation as a whole; we must not allow the industry to be undermined by speculators out to make a fast buck wherever they can. □

[BY PERMISSION OF THE CHAIRMAN:]

Presidente
República de Costa Rica

24 April 1989.
PR-3901-89.

Dear Chairman Rostenkowski:

I am deeply obliged for the your definite support in passing the ethanol provision in the 1988 Trade Act. It granted an extension of the duty free status to Costa Rica's exports of that product to the United States.

Nevertheless, at present I am very much concerned over the threat to eliminate my country's fuel ethanol exports' duty free status as of the 31 December 1989 expiration date. Onerous indigenous feedstock requirements imposed by the 1986 Tax Act will surely resume.

In view of the abovementioned consideration, I ask you again for your support and co-operation to ensure that Costa Rica's fuel ethanol will continue to enter the United States duty free after 1 January 1990.

Please do accept, Mr. Chairman, the assurances of my highest consideration.

Oscar Arias Sánchez

The Honourable
Dan Rostenkowski
Chairman
Ways and Means Committee
United States House of Representatives

EL PASO
REFINING COMPANY
LTD.

6500 TROWBRIDGE
EL PASO, TEXAS 79905
P.O. BOX 9579
EL PASO, TEXAS 79986
915/772-1433
TELEX: 765 120

April 24, 1989

Sam Gibbons
Chairman, Subcommittee on Trade
Committee on Ways and Means
1136 Longworth HOB
U.S. House of Representatives
Washington, D. C. 20515

Dear Congressman Gibbons:

RE: CBERA REAUTHORIZATION

I would like to point out the difficulties that El Paso Refining Company, Ltd. has had and continues to have in purchasing fuel-grade ethanol for blending with gasoline.

El Paso Refining Company, Ltd. sells 1,243,000 gallons of ethanol blended gasoline per month through jobbers. We have contacted the following ethanol producers and are unable to get ANY commitment for supply other than what is noted:

	Remarks:
ADM	58,000 gals. for April 1989 No Commitment for May
New Energy	No Commitment
Pekin	No Commitment

Ethanol is a valuable commodity and helps to improve gasoline and the environment. We endorse the use of this fuel and are concerned about the supply of this product to us. Many small ethanol producers have gone out of business, and we are left with only a few large producers who do not seem to care about supplying small companies such as our company. We support the position of allowing ethanol to be imported from the CBI countries.

Sincerely,

DAVID N. JONES
President
DNJ/JR-k

HARTNEY
OIL COMPANY — SINCE 1916
4801 S. Harlem — o — Forest View, IL 60402 — o — (312) 749-8100

April 25, 1989

Sam Gibbons
Chairman, Subcommittee on Trade
Committee on Ways and Means
1136 Longworth HOB
U. S. House of Representatives
Washington, DC 20515

RE: CBERA Reauthorization

Dear Congressman Gibbons,

I would like to point out the difficulties that my company, Hartney Oil has had and continues to have in purchasing fuel grade ethanol for blending with gasoline.

Our company, Hartney Oil, is one of the largest distributors in Chicago and though the government is highlighting the use of alcohol blended gasoline, we are constantly having difficulty acquiring alcohol from ADM, New Energy and Pekin Energy, not to mention the pricing games they play; in particular favoritism to other customers. There should be a standard pricing program regardless of who the customer is.

It is obvious to us that the demand has overun the availability, therefore, we support the position of allowing ethanol to be imported from the CBI countries.

Sincerely,

HARTNEY OIL COMPANY

Peter Hartney

Peter A. Hartney
Vice-President

PAH:ss

MINNESOTA CORN PROCESSORS

April 24, 1989

Mr. Robert J. Leonard
Chief Counsel, House Ways &
Means Committee
1102 Longworth
House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

Minnesota Corn Processors wishes to make the following statement to the House Ways & Means Committee regarding the duty free entry of European wine alcohol dehydrated in the Caribbean Basin.

Minnesota Corn Processors was established as a cooperative in 1980, and began manufacturing operations in 1983. This farmer-owned cooperative was established by farmers who were disillusioned by the southwestern Minnesota corn prices. They banded together and convinced their friends and neighbors that it was advantageous to build their own corn processing plant. By utilizing their own corn, they could increase the value of the corn processed, thereby controlling their own destiny while improving the net return on their investments.

In 1988, Minnesota Corn Processors began producing fuel grade ethanol at its facility in Marshall, Minnesota at a rate of ten million gallons of fuel ethanol per year. This fuel ethanol is marketed primarily in the state of Minnesota and eastern South Dakota. Currrently, 8% of the total unleaded gasoline sales in the state of Minnesota are ethanol blended fuels. The vast majority of MCP's ethanol is sold in the seven county Minneapolis-St. Paul metro area. Admitting the Caribbean Basin dehydrated, European wine alcohol duty free, would place this European alcohol at the center of this market. Barges of the European wine alcohol would move up the Mississippi and unload at St. Paul, Minnesota.

Because of the inexpensive wine feed stock coming from Europe, and only dehydrating in the Caribbean, the alcohol would be at markedly lower prices. This would effectively eliminate the use of domestically produced product, crush the domestic producers and eliminate a growing farm market. It would frustrate the espoused policy of both the federal and state governments to develop a domestic source of clean, environmentally safe fuel blending components that help the farmers' economics, develop rural industry and pay taxes to both the federal and state governments. All of these positive aspects would be eliminated and paid for by the federal and state treasuries.

P. O. Box 1238 • 400 W. Main St. • Suite 201 • Marshall, MN 56258-1236 • PH: 507/537-0577

MINNESOTA CORN PROCESSORS

Examples of this effect would be lost revenue on the incoming Caribbean dehydrated alcohol, the increased farm deficiency payments and storage cost of excess grain, loss of tax revenues of both the state and federal governments on the lost business and lost employment in rural Minnesota.

We are not opposed to Caribbean alcohol produced from cane sugar, fermented, distilled and then dehydrated entering the U. S. market as a preference item. We request that the duties remain in place on the dehydrated European wine and support American rural enterprise.

Sincerely,

Donald F. Stella
President

DS/sw

cc: U.S. Rep. James L. Obestar
U.S. Rep. Arlan Stangeland
U.S. Rep. Gerry Sikorski
U.S. Rep. Martin Olav Sabo
U.S. Rep. Bruce F. Vento
U.S. Rep. Bill Frenzel
U.S. Rep. Vin Weber
U.S. Rep. Tim Penny
U.S. Senator Rudy Boschwitz
U.S. Senator Dave Durenberger

P. O. Box 1236 • 400 W. Main St. • Suite 201 • Marshall, MN 56258-1236 • PH: 507/537-0577

NATIONAL PETROLEUM REFINERS ASSOCIATION
Founded 1902
SUITE 1000, 1899 L STREET, N.W., WASHINGTON, D.C. 20036
TELEPHONE (202) 457-0480

NPRA COMMENTS ON CBI INITIATIVES

The National Petroleum Refiners Association is a national trade association representing most of the petroleum refiners and petrochemical manufacturers in the United States. Our members see no valid reason to commend extension of duty free provisions contained in H.R. 1233 and S. 504 to petroleum or products derived from petroleum.

First, there is no significant benefit conferred on Caribbean Basin countries' employment rates, since petroleum operations are not labor intensive. There would be greater incentive for existing CB refineries to operate on imported crude oil and export their products to the U.S. This policy change would serve as a clear signal that new refining capacity should be built in CB countries rather than making needed capital investment to improve and upgrade U.S. refineries.

Just as importantly, however, is the effect these provisions could have on the domestic refining industry's competitive standing. The purpose of current U.S. duties on petroleum and petroleum products is to partially offset costs borne by domestic refiners that are not faced by those abroad. For example, CB refiners are not required to comply with the costly health, safety and environmental regulations faced by U.S. refiners. Without tariffs to offset such costs, U.S. refiners will be at an disadvantage compared to their CB counterparts with the outcome being increased imports of petroleum and petroleum products. In an era of concern over growing trade deficits, any move that would have a net effect of increasing imports of petroleum should be questioned, to say nothing of the loss of revenue that would result by eliminating tariffs on imports from CB countries.

While there has been much concern with growing crude oil imports and lower domestic petroleum production, not much attention has been given to declines in our ability to refine the products we need from crude oil. Since 1981, the number of refineries operating in the United States has declined by over one-third. If greater reliance is placed on foreign sources for refined petroleum products, we would be even less able to meet our national security needs during an oil disruption, since we would have fewer sources from which to obtain the needed volumes of appropriate quality refined fuels.

While the NPRA understands the intent of the legislation to encourage economic development in the CB through increased employment, we feel that eliminating duties on petroleum and petroleum products is not an appropriate means by which that goal may be reached and goes against our national interests as well. We believe petroleum and refined products must be deleted from the CB initiative.

NORTH CAROLINA ETHANOL, LTD.
AGRI DEVELOPMENT INCORPORATED - GENERAL PARTNER

105 West Main Street
Post Office Box 748
Faison, N. C. 28341-0748
Telephone: (919) 267-1533
FAX: (919) 267-1433

TESTIMONY OF

NORTH CAROLINA ETHANOL, LTD.

SUBMITTED BY

GUY D. GRISWOLD, PROJECT MANAGER

ON THE IMPACT OF THE

CARIBBEAN BASIN INITIATIVE ON

NORTH CAROLINA ETHANOL'S PLANT

SUBMITTED TO:

THE OVERSIGHT SUBCOMMITTEE
OF THE COMMITTEE ON WAYS & MEANS
UNITED STATES HOUSE OF
REPRESENTATIVES

APRIL 25, 1989

My name is Guy D. Griswold. I am the Project Manager for North Carolina Ethanol, Ltd. This limited partnership proposes to build a 60 million gallon grass roots ethanol facility, using forward integration in the City of Faison, North Carolina. The testimony contained herein identifies the impact of the Caribbean Basin Initiative on our plans to finance, construct, and operate the North Carolina Ethanol facility.

BACKGROUND

North Carolina Ethanol, Ltd. is a limited partnership consisting of five partners who propose to build, using private financing, a forward integrating 60 million gallon per year grass roots full fermentation ethanol plant. The corporation's goals are to:

1. Construct an ethanol plant.

2. Bring industry into eastern North Carolina.

3. Provide North Carolina farmers an additional market for their corn.

4. Be in the forefront of a developing ethanol industry.

The work on this project began in early 1986 when the project concept was created. During 1986, the partners were involved in formulating basic ideas and determining if the overall concept was valid. During this Conceptual Phase, they worked without compensation and contributed their own funds to accomplish feasibility studies, engineering evaluations, and to review contractor credentials. They expended considerable effort and contributed their own time to develop a viable project scope which was feasible, financially sound, and politically accepted within North Carolina. The Conceptual Phase of this project ended in August 1987 with the successful passing of ethanol legislation that provides a North Carolina tax credit for investors.

The Predevelopment Phase of the project commenced in September 1987 with objective to further define the project, obtain an engineering estimate and venture capital funding. During this phase, we created and submitted a request for proposal to contractors and evaluated their submittals, investigated potential sites, obtained utility rates, visited similar type ethanol plants, decided on the type of process to be used, and developed a venture capital syndication package. Throughout this phase as during the Conceptual Phase, the partners funded the effort with their own monies and took no compensation for their efforts. During the first two phases of the project, the Conceptual and Predevelopment Phase I, approximately $150,000 was contributed by the partners plus many man-years of effort.

As a result of the efforts during the Predevelopment Phase I, the partners were able to obtain venture capital funding to continue their predevelopment work. The Predevelopment Phase II began January 1989 with the objective of developing a guaranteed maximum price for the project, formalizing the design criteria, completing the engineering and technological studies necessary, completing the market study, and developing an investment banking prospectus. At this time, work continues to complete the marketing study, complete the air quality permit work, update the estimate and project technical description, and put the syndication package in a form to obtain debt and equity financing. We anticipate this Predevelopment Phase II will take nine to 12 months to complete. Our goal is to complete debt and equity financing before the end of 1989.

As you can see in a short few years, North Carolina Ethanol, Ltd. has invested considerable time and money to develop the project. We currently have a full fermentation grass roots ethanol plant with a capacity of 60 million gallons per year using a forward integration method that costs approximately $105 million. We have extensive North Carolina political support and excellent State, County and local Corn Grower and Farm Bureau support. We also have top quality participants involved with us. Monsanto Enviro-Chem is our turnkey contractor and has indicated they will participate in the equity portion of the financing. Energy Resources and Logistics, a wholly owned subsidiary of CSX Transportation, will construct the cogeneration plant. In addition to our efforts to develop the project and obtain funding, Duplin County is planning to provide a water and wastewater system and to accomplish some site improvements to support our ethanol facility. They have already filed applications to get the necessary grants and funding amounting to some $4,500,000. At the State level, we are also receiving excellent support. Legislation is being prepared to establish an ethanol committee that will educate and promote the use of ethanol throughout the State. This project is not one dimensional, but both the County and the State have recognized the importance of it to the farmers and to the County areas. We are providing an agri business in an agricultural State in an area where economic and industrial development is necessary. These achievements have not come without considerable effort and time from all the partners and with the support of many of the legislators and County officials. This project will provide a significant industrial development with economic impacts that cover the entire State. It is our opinion that the Caribbean Basin Initiative which allows the transshipment of wine alcohol into the United States can adversely effect our ability to obtain financing, and possibly stop our development in its tracks.

PROJECT DESCRIPTION

Our North Carolina ethanol plant is a grass roots full fermentation 60 million gallon per year dry milling plant using corn as its raw material. We estimate the plant will cost approximately $105 million to construct and start up. The plant will cover some 60 to 70 acres and will include 1,200,000 bushels of corn storage, corn grinding and processing, a full fermentation area, distillation and dehydration towers, Distillers Dried Grains with Solubles (DDGS) drying capability and product load out. In addition to the primary plant facilities, we will have maintenance shops, cooling towers, maintenance equipment, administration areas, electrical distribution systems, cooling towers and water distribution systems, and railroad and road improvements. This forward integration ethanol project is a huge endeavor that encompasses and includes all the features required to operate a full fermentation plant.

ECONOMIC IMPACT

Our ethanol plant, in addition to providing new industry, additional jobs and opportunities in the County, will serve as the stimulus to bring other new industry into the area. With our ethanol plant will come a cogeneration facility to be constructed by Energy Resources and Logistics, a wholly owned subsidiary of CSX Transportation, and a CO_2 plant to be constructed and operated by a major CO_2 company. These two associated industries will add another $110 million of private sector capital investments to Duplin County. In addition to these private investments, the County itself will fund and construct water and wastewater system to support this industrial development. Electrical distribution lines, road systems and railroad systems will all be expanded to support this development. This industrial development will represent the largest single economic impact in eastern North

Carolina in recent years. The total private capital investments projected for Duplin County will exceed $210 million.

The impact of this industrial development is to strengthen rural America. It will have a direct impact on Duplin County in the following manner:

1. The three industries will create between $800,000 and $1,000,000 per year in additional tax revenue.

2. During construction 200 to 600 jobs will be created.

3. During operation, the plants will employ between 125 to 150 people.

4. We estimate the annual payroll to be $2.5 million per year for these three industries. Using a conservative estimate, when this money recycles through the community, it will increase five times therefore creating a $12 million economic benefit to Duplin County and surrounding area.

5. We will create additional jobs in the transportation industry due to the movement of raw materials and products into and out of the plants.

6. We will create support jobs in the surrounding area on a basis of 1 to 1. Therefore within the surrounding communities, 125 to 150 additional jobs will also be created.

7. The three industries forming the initial industrial development will create an anchor for future industrial development. Our development will provide the basis for future expansion of diverse agri related business in the adjacent Duplin County industrial park.

8. The CO_2 gas from our fermenters will, after processing, provide liquid CO_2 for quick freezing of processed poultry. This area of North Carolina processes a large number of turkeys and chickens for human consumption. At the present time, the CO_2 for these industries is hauled long distances to these processing plants. With a source of CO_2 available, the quick freezing of poultry should expand and also be more economical.

9. The ethanol plant will stimulate the activities at the ports in Wilmington and Morehead City due to the shipment of ethanol and Distillers Dried Grains with Solubles up and down the eastern seaboard.

10. The industrial development will insure that CSX Transportation continues to provide rail service to this area and will encourage further development on the railroad.

It is obvious that one ethanol plant has a profound and extensive economic impact on this eastern North Carolina county. Our objective to provide the farmers more market for their corn and stimulate North Carolina corn growth is only one small aspect of the economic improvement we can create. Our ethanol plant and its associated industries will be compatible with the agricultural nature of this area and give it a badly needed economic shot in the arm.

MARKETING

In addition to our desire to improve the North Carolina farm economy, one of our reasons for locating our plant in eastern North Carolina was the accessibility to east coast ethanol markets. There are currently no major forward integrating full fermentation ethanol plants located on the east coast. Although ethanol for the

coastal areas is provided from the midwest, with a plant in North Carolina, we will service those areas more economically and also create more ethanol demand. However, there is a significant portion of the population of the United States located east of the Mississippi. By being in North Carolina, very close to the Interstate Highway 95 going north and south as well as being close to the coast, we will have access to the east coast ethanol market. Our primary ethanol market areas are the States of North Carolina, South Carolina, Georgia, Florida, Virginia, Maryland, Kentucky and Tennessee. It is possible from our North Carolina location to reach all these states easily within a twelve hour period by driving. Furthermore, movement by rail and/or barge is possible to supply large quantities of ethanol to the metropolitan areas on the east coast. However, because of our proximity to the Caribbean we can be and will be substantially impacted by any wine alcohol transshipped through the CBI into the ports on both the Gulf of Mexico and east coast.

CBI ECONOMIC RAMIFICATIONS

Because of the ethanol industry's past history with plant financial difficulties, we have consciously looked at the economic factors that are involved in an ethanol project and attempted to identify and control those we can. We can control project costs, technology, operational and maintenance costs. However, it is impossible for us to control outside influences such as the market value of ethanol. However, our financial success depends in large part upon the stability of the ethanol price and upon our ability to accurately project its value. At this point, we have commissioned Information Resources, Inc. to accomplish a market study to determine our ethanol price and our market area. However, this study, as it addresses CBI ethanol imported duty free, can create uncertainties in the bankers' minds about the ethanol market and the price we can expect for our product. It would require considerable efforts on our part to allay their concerns and, if we cannot satisfy their questions, they could slow down their work to obtain financing or decide the risk is too high and walk away. In addition, should our venture capital players (those that have contributed the money for our Predevelopment Phase II work) become concerned that the CBI could adversely effect our project, they could withdraw their funding, therefore stopping our project immediately.

Considering the positive impact we are having on the State and County, our not being able to complete our project would have a cascading affect on much of the development presently planned. The local impact would be that the expansion of the transportation systems, the improved County electrical distribution, the CO_2 industry, and the cogeneration plant would not be constructed. The additional tax revenues that the industrial development would create would not be available for the County to use to develop additional industry and to upgrade their school system. The potential total affect of the CBI goes beyond an impact of the ethanol plant and could destroy the County's plans for economic development within Duplin County.

BACKWARD INTEGRATION

North Carolina Ethanol, just as every other major ethanol production facility in the United States, is practicing forward integration of the project. We recognize that to construct the full fermentation process using forward integration is more costly, takes longer to develop and has a much higher risk. This type integration, when combined with private financing, requires considerable effort on our part to insure success. We have been involved in careful planning, exacting review of the technology and we know that that type of effort will be required throughout the

entire project life. We also recognize that it will take considerably longer to recover our investment than it would if we were to use a backward integration method. However, we are committed to this forward integration philosophy because it is the only reasonable way to construct an ethanol plant and, at the same time, provide the farming community an additional market for their corn. A forward integrating plant such as ours using corn as the raw material assists not only the ethanol industry but helps the Federal government by reducing their payments necessary for grain storage.

Our project and associated industrial development provides additional jobs to support the North Carolina rural economy, creates 125 to 150 new jobs in rural America worth $2,500,000 in additional salaries and provides $800,000 to $1,000,000 in new county tax revenue. This is a commitment on the part of North Carolina Ethanol and the other members of the industrial development to rejuvenate the rural economy and not simply to take the fastest way to recover their costs and make a quick profit.

The backward integration theory promoted by some of the Caribbean Basin entrepreneurs does not do for the economy of those areas what our plant proposes to do for the rural economy of North Carolina. To me, it appears unequitable to promote a Caribbean Basin Initiative that allows the simple dehydration of wine alcohol at the expense of a North Carolina ethanol plant which provides so much more for not only the industry but the community in which it is located. If the Federal government's objective is to create additional jobs and enhance the Caribbean Basin with an ethanol industry, then they should require considerable use of local agricultural feed stocks to discourage those opportunists who would simply put in a wine alcohol dehydration column. With minimal costs, a dehydration column can be erected and it does not provide the jobs that a full fermentation grass roots facility would. As the United States ethanol industry development has been stagnate over recent years, it would appear that Congress would attempt to stimulate the United States' ethanol industry and its development and not to protect those opportunists in the Caribbean Basin who would attempt to dehydrate and transship wine alcohol from European areas. Without requiring the Caribbean Basin manufacturers to use a majority of local feed stock and to forward integrate their plants, the ethanol industry in the southeast United States and specifically North Carolina Ethanol, Ltd. will have a difficult time obtaining financing.

North Carolina Ethanol would like the opportunity to do this backward integration if it is to remain available for the Caribbean Basin manufacturers. Such backward integration would allow us to minimize our costs substantially, increase our chances of getting funding, and decrease the length of time required for us to recover our investment. However, for backward integration to be effective, we would have to have the use of the European wine alcohol just as the Caribbean Basin does. We recognize that under the current law this is not possible. Therefore, if Congress is not going to change the laws to allow European wine alcohol into the country, they should not penalize North Carolina Ethanol by asking us to function in a different environment than the dehydrators in the Caribbean Basin. We have no objection to competing with a full fermentation grass roots plant in the Caribbean Basin which uses raw materials from their country to produce ethanol. However, it is quite unfair for us to be forced to compete with a Caribbean Basin industry which is not designed and operating with the same criteria to which we are.

SUMMARY

At this point, we are receiving conflicting signals from the Congress. On one hand, they are looking at extending the ethanol

excise tax exemption, extending that tax exemption to ETBEs, pressing for clean air which can be achieved through oxygenated fuels and generally expressing increased support for ethanol. On the other hand, they are trying to decide what to do with the Caribbean Basin Initiative which would allow wine alcohol transshipped through the Caribbean to enter the United States free of the import duty. This transshipped alcohol which has just been dehydrated will have a serious impact on North Carolina Ethanol and our market for ethanol in our primary market areas. Furthermore, the wine alcohol will effect the price of ethanol so that we cannot accurately predict the market price we could expect; therefore, casting doubt upon our financial projections. With doubt in our financial projections, it is possible we will not be able to obtain debt and equity funding in the private sector.

The Caribbean Basin Initiative does more than effect North Carolina Ethanol. If the North Carolina ethanol plant is not developed, the cascading impact is disastrous and extends throughout the entire eastern portion of the State. At a time when the ethanol industry is poised to make a significant impact on the environment and the gasoline industry, it would be a shame for one piece of legislation which is intended to assist the Caribbean Basin countries to develop full fermentation ethanol industry to be used by entrepreneurs and opportunists for their own personal benefit at the expense of North Carolina Ethanol and the developing ethanol industry in the United States. We recognize that it is the American way to make money; however, all we ask is that all ethanol projects be treated equitably and be able to compete on the same basis with their product. It is unfair for North Carolina Ethanol to design, build and operate to one set of standards while the Caribbean Basin Initiative opportunists can develop a dehydration tower and provide the same product free of import duty to a different set of standards. The bottom line is North Carolina Ethanol proposes to build a plant to service the coastal states on the Atlantic seaboard. The Caribbean Basin Initiative has the possibility of stopping our development during the Predevelopment Phase before we can even get into production.

This North Carolina Ethanol project has real sizzle. It is an agri business in an agricultural State which will assist the farmers by providing more market for their corn. The project includes top quality companies and commands support throughout the State. We will produce a renewable fuel (ethanol) which will improve our environment. However, all these factors aside, our project is significantly effected by the market value of ethanol and the impact the Caribbean Basin Initiative has on our ethanol market and our market value. The Caribbean Basin Initiative can take the sizzle from a most promising agri business development.

S & F PETROLEUM CO., INC.
P.O. BOX 98
ADKINS, TEXAS 78101-0098
7625 HWY. 87 E.
SAN ANTONIO, TX 78263-9633

STEVE FARLEY
(512) 658-2648
T.W. "WOODY" WOODRUFF
(512) 648-2707

April 24, 1989

Sam Gibbons
Chairman, Subcommittee on Trade
Committee on Ways and Means
1136 Longworth HOB
U.S. House of Representatives
Washington, D. C. 20515

RE: CBERA Reauthorization

Dear Chariman Gibbons,

I am writing to express my concern about the shortage of ethanol in Texas and apparently in the USA. I own and operate a small gasoline distribution business and have used ethanol blends for over 4 years. As my business has grown, I have established a terminal to enable me to purchase ethanol in larger quantities than just a few gallons at a time.

I have asked all of the producers of ethanol, that I know, to supply ethanol to me on a volume basis. They have all said that at this time they would not committ to any volume purchases. I spoke with ADM, Pekin Energy, Southpoint Ethanol, and New Energy, and heard the same story from each of them. I have not been a historical buyer in quantity and they were not prepared to take on new business at this time.

I understand that there are several small ethanol producers in the Caribbean that do supply ethanol to the USA on a duty free basis. I certainly support their effort and cannot see how they could adversly effect the ethanol industry in the USA.

We need all of the ethanol we can get. I hope that you will consider this letter of support for the CBERA.

Sincerely,

Steven F. Farley
President
S & F Petroleum Co. Inc.